

# Can Stock Exchanges Support the Growth of Small and Medium-Sized Enterprises?

Lessons from India, South Africa, and Jamaica

A report from the Milken Institute Center for Financial Markets

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## ACKNOWLEDGMENTS

We would like to extend our thanks to the many people who made this study possible through their guidance, insights, and support. In particular, we would like to express our deep appreciation for our partners at the World Federation of Exchanges (WFE), with whom we collaborated on the design of this survey, as well as survey fielding in South Africa: Siobhan Cleary, Head of Research and Public Policy; Stefano Alderighi, Senior Economist–Researcher; and Tatiana Chekanova, then-Economist and Statistician.

Several people shared helpful thoughts and feedback as we developed the study’s focus, design, and findings. We would like to thank Reena Aggarwal (Georgetown University); Chris Brummer (Georgetown University and the Milken Institute); Matthew Gamser (SME Finance Forum, International Finance Corporation); Alison Harwood (then-IFC); Shigehiro Shinozaki and Noritaka Akamatsu (both of the Asian Development Bank); and Betty Wilkinson, Financial Sector Deepening Zambia. We would also like to thank Wayne Beecher and Tetsuro Narita (both of the Inter-American Development Bank), who shared their insights and helped us build the survey sample in Jamaica, and Roelof Goosen (former Director of Financial Inclusion at the South African National Treasury), who provided insights and advice on building the survey sample in South Africa.

We would also like to extend our gratitude to the stock exchange officers and managers who took the time to help us to better understand their markets and to offer their guidance. Our thanks to Ashish Chauhan and Ajay Kumar Thakur (Bombay Stock Exchange); Nicole Cheyne and Michelle Joubert (Johannesburg Stock Exchange); and Marlene Street-Forrest and Patrice Smith-Lindo (Jamaica Stock Exchange).

Milken Institute interns Christopher Benson and Atul Menon assisted in fielding the survey. Intern Dylan Clement assisted with organizing the survey data. The Milken Institute’s Vanessa Taylor provided assistance to the authoring team. Jill Posnick, Heather Fields, and their team managed communications, report editing and design.

Finally, the authors would like to thank Staci Warden, executive director of the Milken Institute Center for Financial Markets, for her guidance and feedback throughout the project.

**OVERVIEW**

Despite their importance in creating private-sector jobs and diversifying economies, small and medium-sized enterprises (SMEs) often struggle to access adequate finance. This problem has only become worse since the global financial crisis, due to bank deleveraging and possibly the adoption of stricter prudential regulations. This more challenging financial environment has spurred policymakers, international donors, civil society organizations, and the private sector to seek out and encourage alternatives to traditional bank financing for SMEs, including public equity financing through dedicated SME market segments.

Today, there are around 30 SME-dedicated market segments on stock exchanges in emerging-market and developing economies, the majority of which have been established in the past 15 years. While public-equity financing is not a broad solution to SME financing challenges, especially in emerging-market and developing economies, it *may* be a solution for a particular subset of SMEs—specifically, those SMEs that have strong growth prospects and that are sufficiently institutionalized to handle the necessary reporting and corporate governance requirements. This is a very small subset of SMEs, even in advanced economies. Furthermore, many stock exchanges in these economies already struggle with low listings, small market capitalizations, and illiquidity. SME boards in these economies may find these issues even harder to deal with.

SME boards have sought to attract listings in various ways including by offering a more streamlined and quicker listing process, reduced fees, and even tax incentives. Some of these approaches have attracted criticism as seen in a small, but growing number of studies on this topic. As far as we know, however, there has been very little research at the country level that comprehensively examines the effectiveness of SME exchanges from the perspective of listed and unlisted SMEs themselves.

Through a survey instrument that we created jointly with the World Federation of Exchanges (WFE), the Milken Institute Center for Financial Markets carried out evidence-based research to compare how approaches to SME boards have varied across countries. We surveyed listed SMEs on the SME boards and main markets of three focus countries—India, Jamaica, and South Africa—to compare why these firms list, whether they have had better access to finance since going public, and whether their post-listing experience has met their expectations. We looked at whether, and to what extent, SME platforms are “graduating” SMEs—that is, incubating them for later listings on the main board. (See Box 1 below for a summary of our study’s methodology and the survey sample.)

We also surveyed unlisted SMEs to understand their views of becoming a public company and why they may have opted not to list. We asked unlisted and listed SMEs what could be done to attract more SMEs listings to the local capital market. And we asked firms how the experience of getting and staying listed could be improved.

The report that follows proceeds with an executive summary of core, cross-country findings, followed by a survey of previous literature on this topic. We then examine country-specific findings in greater depth for our focus SME boards—the SME Platform of the Bombay Stock Exchange, the AltX of the Johannesburg Stock Exchange, and the Junior Market of the Jamaica Stock Exchange—each covered in its own chapter. The final chapter offers conclusions based on the survey findings from these markets.

### Box 1. Study methodology and survey sample

#### Selection of SME exchanges

The authors selected three SME exchanges in emerging markets based on a review of the secondary literature and analysis of worldwide data collected by the World Federation of Exchanges (WFE) and the Milken Institute. These exchanges are the Bombay Stock Exchange’s SME Platform in India; the Johannesburg Stock Exchange’s Alternative Exchange (AltX) in South Africa; and the Jamaica Stock Exchange’s Junior Market.<sup>i</sup> We selected these exchanges for their activity and size, as measured by listing activity and market capitalization, as well as for their regional diversity.

#### Survey design and implementation

Two distinct surveys were fielded in each of the three focus countries. The first was directed toward senior managers at each of the three SME exchanges. The second was directed toward the senior managers of listed and unlisted SMEs in each of the three focus countries—mainly, chief executive officers and chief financial officers. We sent the second survey to SMEs listed on the SME exchange and the main board of each focus country.<sup>ii</sup> Unlisted firms were judged as plausible listing candidates—and therefore, appropriate for inclusion in the survey—if they had between 100 and 200 employees (a common, but not universal, definition for unlisted, medium-sized companies). Unlisted firms were identified through lists provided by industry associations, development institutions, and the stock exchanges themselves.

In India, the sample was divided roughly evenly between unlisted firms and listed firms—which were themselves split roughly evenly between main-board firms and SME Platform firms. In Jamaica and South Africa, by contrast, the response rate was higher for unlisted firms than for listed firms.

#### Survey sample

	Unlisted firms	Listed firms			Total
		Main board	SME board	Total listed	
India	25	14	12	26	51
Jamaica	29	1	13	14	43
South Africa	32	6	6	12	44

i For WFE-member exchanges, the WFE shared annual data on new listings and delistings, total listings, market capitalization, and a few other select metrics. For non-WFE-member exchanges, the Milken Institute collected separate data—primarily through direct outreach to the exchanges themselves.

ii Firms listed on the main board were classified as SMEs if they had a market capitalization that was at or below the median market capitalization of the country’s SME exchange as of mid-summer 2016.

## EXECUTIVE SUMMARY

In this report, we discuss the main cross-country findings that emerged from this survey-based research program's core study questions:

- Why do SMEs list—and where?
- Does listing help SMEs access finance—and how?
- Would listed firms list again?
- What keeps unlisted firms away?
- How could listing be made more attractive?
- Are SMEs graduating to main boards—and is this an actual aim of the firms and stock exchanges?

The chapters that follow analyze and detail the findings by market for the study's three focus countries: India, South Africa, and Jamaica. Each country chapter follows the same, standard outline of core questions, to facilitate cross-country comparison. The main findings of the study are summarized here.

### **The decision to list**

Firms may list on a stock exchange for a variety of financial and non-financial reasons. In specific market contexts, a public offering may make sense for a subset of SMEs including those with solid growth potential and other characteristics. Through our survey, we explored the main motives that drove listed SMEs in our focus countries—India, South Africa, and Jamaica—to take the decision to go public. We also compared the listing motives of SMEs on the main market and SME platforms of the focus countries. Finally, we looked at whether there is any disconnect between SMEs' top motives for listing and what the respective stock exchanges perceive as the main drivers of listings. We found that, for the most part, these three SME exchanges correctly perceive what motivates firms to list with a few important exceptions. Where this disconnect exists, stock exchanges may be missing opportunities for targeted, two-way communication with firms that would better inform and attract some of them to list.

The firms we surveyed listed for a variety of reasons, and the relative importance of these reasons in driving that decision differed across the countries. For example, we found that the top reason SMEs in India sought a listing on the SME Platform of the Bombay Stock Exchange (BSE) was to improve their access to finance, directly and indirectly. In contrast, SMEs in South Africa and Jamaica told us they were most strongly motivated to list to position themselves for higher growth and visibility. Although participating firms listing on both the SME and main boards in South Africa and Jamaica had the same top reason for listing—positioning themselves for growth—this motive held more strongly for SME-board firms. One possible explanation could be that many of these firms may be at earlier growth phases of their business life cycles. Notably, a majority of new listings on South Africa's AltX over the past five years were firms seeking exit for early-stage investors.<sup>1</sup>

A high number (about one-quarter) of surveyed SMEs on Jamaica's Junior Market said access to tax breaks was among the main drivers of their listing. This finding for Jamaica is notable because all of these firms specified this motive unprompted—as among the “other” reasons they gave for driving a listing. Unlike the other countries in this study, Jamaica offers tax breaks as incentives to attract firms to list on the stock exchange's Junior Market.



In all three countries, SMEs' top motives for listing broadly align with the stock exchanges' original aims for setting up these SME platforms and current motives for operating them. Among all three exchanges' most important motives for setting up the SME boards were to increase access to restricted and costly medium- to long-term financing for SMEs, as well as to help firms grow.

Generally, these three SME exchanges correctly perceive what motivates firms to list. However, there are some exceptions. For example, stock exchange managers in all three countries may overestimate the importance that currently listed and prospective SMEs attribute to improved financial reporting and transparency as a direct benefit of listing, as relatively few listed SMEs on these exchanges consider the opportunity to improve financial reporting as a main motive. Among the three countries, a somewhat larger share of SMEs on Jamaica's exchange (33%) considered this an important reason for seeking a listing. Stock exchanges could engage in more education and awareness-raising with current and prospective listed firms on this aspect of a listing, emphasizing that other benefits—such as expanding the investor base—depend on disclosure and good corporate governance.

In South Africa and India, stock exchanges may also be underestimating the importance firms place on diversifying the investor base as a major driver in listing on SME exchanges (cited by around half and just under 60 percent of firms, respectively). Companies typically take more interest in diversifying their investor base as they grow and mature in their listing cycle—particularly those that migrate to the main board. In fact, the tendency of pension funds and other institutional investors, in general, to prefer to invest in larger firms can pose a significant challenge to SME boards in generating sufficient trading activity and liquidity.<sup>2</sup> The apparent incongruity of this typical pattern and preference with our survey findings could be partly due in South Africa to changing characteristics of AltX firms in the past several years—where family-owned firms make up a smaller share of new listings.<sup>3</sup>

These areas where SME exchanges did not correctly perceive what motivated firms to list highlight that more two-way, ongoing communication about how these firms perceive listing's benefits and disadvantages could reap benefits. Stock exchanges that are closely attuned to the various reasons SMEs list may be able to sharpen their appeal to attract new candidates to their SME platforms. Stock exchanges also may be able to boost SME listings by being more aware of the different benefits that firms expect from a main board listing versus an SME platform listing. In all of these cases, more could be done by the stock exchanges and other capital markets stakeholders to address the disconnect between SMEs and stock exchange managers.

#### **Listed SMEs and access to finance**

One of the most important reasons firms list is to increase their access to finance. Most firms raise funds directly on the stock market when they list. Whether or not they raise funds upon listing, listed firms may also be able to tap other sources of finance more easily than similar, unlisted firms. This is because the process of listing requires firms to meet strict financial reporting and corporate governance requirements. Meeting these standards improves accounting practices and financial management, thereby increasing firms' transparency and potentially improving their creditworthiness. Furthermore, by raising equity capital, firms can reduce their leverage ratios, which may also make it easier for them to obtain credit on more favorable terms.<sup>4</sup>

Our survey results indicate that improving their access to finance—both directly and indirectly—was a common factor in many firms’ decision to list. Across all three countries, most surveyed firms listed via an initial public offering and most firms raised capital at the time of listing. All surveyed Jamaican firms raised capital upon listing, as did nearly all Indian firms. South African firms were the least likely of the three cohorts to raise capital upon listing—only two-thirds of surveyed firms reported doing so. South African firms were often motivated to list for reasons other than raising new capital—most notably, to provide exit opportunities for early investors.

Most surveyed firms accessed additional medium- to long-term financing subsequent to their initial public offering (IPO). Importantly, this includes most of the firms that listed in order to improve their access to finance. Across all three countries and all market segments, banks were the most common source of post-IPO financing. Other common sources of post-IPO financing included securitization (in India), leasing (in India and South Africa), and bond issues (in Jamaica). In general, however, firms on the SME exchanges were less likely to access post-IPO finance than were firms on the main boards. About a quarter of surveyed firms on each of the three SME exchanges did not secure any additional post-IPO financing.

These survey findings lend support to the idea that when firms improve corporate governance and financial reporting in order to meet listing criteria, they can also improve their ability to access finance from banks and other sources. However, this should be interpreted carefully: it may be that at least some of the firms that choose to list are, relative to their unlisted peers, already more financially sound and have better growth prospects. These firms therefore may be in a better position to raise external finance even before they go public.

To measure the potential impact an SME board may have on economic development, it is also important to understand how firms deploy the capital they raise. An important function of capital markets is to enable firms to raise capital for longer-term investments that they hope will raise their growth potential. Such post-IPO investments may be aimed at expanding production within existing product lines by investing in staff or fixed assets (such as buildings, factories, and machinery) or they may be aimed at expanding into new markets.

Across all three countries, most firms used their IPO proceeds for some combination of short- and long-term funding needs. Among surveyed firms across countries, one of the most common uses of IPO proceeds was to finance inventory and other working capital needs. However, few firms reported using their proceeds for this purpose alone—most also reported using them to make long-term investments. For listed firms in India, the other two most common uses of IPO proceeds, after working capital, were for long-term investments—either investments in factory and equipment or investments in product development. However, firms on the BSE’s main board were more likely to make such long-term investments than were firms on the SME Platform. In South Africa, firms on the AltX were just as likely to devote some of their IPO proceeds to new product development as they were to working capital needs. In addition, firms on the AltX directed their proceeds to a wider variety of uses than did firms on the main board. Among firms listed on Jamaica’s Junior Market, the two top-cited destinations for IPO proceeds were working capital and investments in factory and equipment.

### **Assessing the listing experience**

A concern facing SME-dedicated market segments in emerging and frontier markets is that a listing will not deliver promised benefits to firms (due to lack of investor interest and/or low trading volume), that listed firms will founder, and that, as a result, the number of new listings will quickly fall off. Contrary to these concerns, though, majorities of listed SMEs across our three target countries were satisfied enough with their experience to say they would go through it all over again in order to achieve the benefits of being a public company. Furthermore, most SMEs that list on SME-dedicated market segments found that the experience met their expectations across most indicators we studied. In India and Jamaica, a large percentage of firms reported that listing exceeded expectations, at least in several core areas, including financial performance and firm visibility.

Overall satisfaction was most pronounced on the Jamaican Junior Market, where 83 percent of listed firms reported that, yes, they would repeat the listing process. Jamaican firms saw the governance and reporting changes their firms had to make to meet listing requirements as leading to positive outcomes in firm performance. In India, two-thirds of listed SMEs would repeat the listing process based on their positive experiences, and increasing access to finance was the core factor determining their satisfaction. Only a slight majority of listed South African SMEs reported that they would list again.

Survey data in India and South Africa allowed us to compare the experience of SMEs listed on the main board versus the SME board.<sup>iii</sup> In both countries, the SME segments appear to do a better job mitigating some of the pressures of going public. In India, firms on the BSE SME Platform rank their experience more positively in terms of the resources required to meet ongoing listing requirements, the resources devoted to investor relations, and pressure from shareholders. In South Africa, an AltX listing appeared to insulate SMEs from the severe external scrutiny faced by firms on the main market. It may also be that the handholding provided by authorized intermediaries facilitates a smoother listing process for firms that choose to list on SME-dedicated boards.

Survey findings also support recommendations in the existing literature that SME boards should reduce disclosure frequency, rather than content.<sup>5</sup> The BSE SME Platform only requires semi-annual disclosures compared to the quarterly requirement of the main market. Yet firms listed there reported improved access to finance and better financial performance as outcomes of listing as often as did firms on the main market. Furthermore, South African and Jamaica firms listed on SME boards—where they faced the same filing requirements as firms on the main board—were more likely than their Indian peers to report that the costs of maintaining a listing were more severe than they had anticipated prior to going public. Reduced reporting frequency could alleviate some of these costs, particularly in Jamaica. In South Africa, where both firms on the main board and the AltX report semiannually, further reducing reporting frequency is not recommended.

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iii The Jamaican Stock Exchange has a much smaller number of total listings overall and very few listed companies on the main market, perhaps only one, that would meet the definition of an SME.

### **How unlisted firms view listing**

For SME boards to remain viable they need to attract a steady stream of new listings, and so it is important to understand how unlisted SMEs view the process and outcomes of going public. Across the three target countries, a clear yet unsurprising relationship emerged between the perceptions of unlisted firms and their interest in a future listing. In India, where unlisted Indian SMEs clearly associated going public with potential drawbacks more than possible benefits, none of the SMEs in our sample would consider a future listing on the stock exchange. About a fifth of South African SMEs would do so, and perceptions there were split between positive and negative associations. In Jamaica, 83 percent of unlisted Jamaica SMEs would consider going public in the future, an obvious reflection of the highly positive views these firms held about what it meant to be a public company. The implication of these findings is that improving perceptions about the outcomes of going public may improve the success of outreach efforts to the target population of SMEs that would be good candidates to list.

In both India and South Africa, views of unlisted firms seemed to be shaped more by the experience of firms listed on the main board than those on the younger SME segments. In India, for instance, the top concerns of shareholder pressure and loss of company control more closely reflected the experience of surveyed firms on the BSE main market than those on the SME Platform. Likewise, in South Africa, strong associations of listing with shareholder pressure and liquid trading more closely align with the experiences of firms on the Johannesburg Stock Exchange's main market. In both cases, there may be an opportunity for stock exchange management to emphasize the experience of firms on the alternative boards to counter longstanding views among the pool of SMEs they will look to for future listings.

For those unlisted SMEs that had previously considered going public, the majority could not move forward with a listing for the simple reason that they did not meet the minimum thresholds. For those firms that considered a listing, met the requirements, but ultimately did not list, the reasons for their decision varied across countries. In India, these firms determined that listing was too expensive or that the listing requirements had entailed changing too many business processes. In South Africa, these firms were more concerned about the costs of maintaining a listing more than the upfront resources required to get listed. In Jamaica, interestingly, a lack of information about listing contributed to the decision-making process of this group. Notably, it was rare for firms in any country to report that they decided not to list because they found better financing elsewhere.

### **Making listing more attractive**

Firms can incur considerable costs when going public. In addition to the direct costs of listing fees, indirect costs include the changes firms must make to comply with the reporting and corporate governance requirements associated with listing. While the changes firms must make ahead of listing can discourage otherwise eligible firms to list on main boards,<sup>6</sup> even the more streamlined processes and requirements for SME platform listings can deter firms. For this reason, it is not surprising that further simplification of listing procedures is a top change that unlisted, qualifying SMEs in India and South Africa said would encourage them to reconsider listing. In Jamaica, in contrast, only a minority of unlisted firms said simplified procedures would prompt them to reconsider. Unlisted, yet eligible Jamaican SMEs said technical assistance to prepare for operating as a public company would be more likely to encourage them to rethink the listing decision.

In theory, cutting the amount of time devoted to the process could encourage at least some firms to consider listing. Listing times can range widely by firm across countries. Listing times for surveyed South African firms on the SME board in more recent years have fallen, running three to four months. Surveyed Jamaican SMEs spent an average of five months to prepare a listing. Our findings show that in South Africa and Jamaica, surveyed SMEs that are eligible to list—but have not—do not find the time involved to be a major deterrent. In India, the shortest preparation time for listing on the SME Platform was six months, but it took a third of surveyed firms at least a year to list. Indian SMEs nevertheless told us that they do not view the time required to prepare an IPO as a significant deterrent.

The perception that listing is difficult can be as much a deterrent as the actual procedures and processes involved. Eligible firms make listing decisions by weighing their perceptions of listing's associated procedures and processes against the perceived benefits they expect once the listing process concludes. Although the stock exchange provides education and awareness outreach on listing's benefits to SMEs in all three countries, very few surveyed SMEs that went on to list were aware of these programs. Outreach to prospective firms in India and South Africa appears to be more important for attracting listings to the SME Platform than to the main market.

Unlisted SMEs' overall lack of understanding in India and South Africa about the ongoing costs and requirements of operating a public company flags an opportunity for capital markets stakeholders to bridge this information gap with qualifying, yet unlisted firms. In Jamaica, there is a relatively high level of awareness among unlisted, yet qualifying SMEs about what it takes to get and stay listed—yet half of these firms do not have sufficient clarity on the ongoing costs. Jamaican SMEs' overall higher awareness of what going and staying public involves could reflect the partnership approach taken by Jamaica's Junior Market and other organizations to run education and awareness programs to inform SMEs of the benefits of listing. In particular, the Inter-American Development Bank provides advisory and technical assistance that specifically promotes the Junior Market and aims to strengthen and prepare potentially-listable SMEs.

At a minimum, increased emphasis by capital markets stakeholders in the focus countries on clearly communicating what these costs and requirements entail to unlisted, qualifying SMEs may provide more of them with the information they need to make a more informed decision. This may help address any confusion among unlisted SMEs about the ongoing costs of being listed, which could be deterring some firms more than the actual financial and operational costs. By enlisting intermediaries in these outreach efforts, stock exchanges may be able to more effectively disseminate knowledge and address concerns about the benefits and overall impact of going public (see Box 2).

Finally, a top change that unlisted, yet qualifying SMEs across all three countries said could motivate them to reconsider listing is tax incentives. In Jamaica's case, this finding must be interpreted in the context of developments at the time of fielding the survey—when the status of existing 10-year corporate tax breaks temporarily came into question.<sup>iv</sup> Yet tax incentives was a top-ranking change that surveyed Indian and South African unlisted SMEs also said would make them more likely to list in future. Comprehensive information from Jamaica and other countries' experiences on the impact of these kind of tax incentives is limited. The total impact on fiscal revenues and the overall economy is difficult to decipher and likely mixed. In the short-term, tax breaks likely reduce fiscal revenues. Over the long-term, if listed firms grow, the overall taxable base expands, and the 100 percent tax break expires, there could be a more positive impact on fiscal revenues. Tax breaks are controversial, however, particularly when they become the main motive in a listing and if they reduce investor confidence in the quality of the listing tier.

### **Box 2. Listed SMEs value the prelisting assistance that intermediaries provide**

As many stock exchanges do, the SME platforms in our study's three focus countries make use of authorized intermediaries to assist firms going public. In fact, all three countries' SME boards require firms preparing to list to work with authorized intermediaries. In India and South Africa, authorized intermediaries include brokers, financial advisors, law firms, consulting firms, and merchant banks. For Jamaica's Junior Market, authorized intermediaries must be licensed brokers.

The length of time these intermediaries must remain with firms varies quite a bit across the countries. In South Africa, it is mandatory for the intermediary to remain with the listed firm on an ongoing basis for the duration of its listing. In India, the intermediary must remain with the listed firm for at least three years post-IPO. In Jamaica, authorized intermediaries are only required to work with firms up until the actual listing. Despite these cross-country differences in the mandatory time for intermediaries to work with SMEs that list, our findings clearly show that listed SMEs value the services of authorized intermediaries particularly during the prelisting stage. A large majority of surveyed SMEs specifically cited preparing pre-IPO due diligence and providing assistance to firms in complying with listing requirements as useful to very useful.

### **Graduating to the main board**

Many SME exchanges are housed under a larger exchange, and they often allow listed firms to graduate to the exchange's main board once these firms have reached a certain size or age. This serves two functions. First, it reduces the likelihood that an SME exchange will host firms that are too large to be included in the target population—such firms would not be the appropriate beneficiaries of the exchange's reduced listing requirements and fees.<sup>v</sup> Second, it allows the SME exchange to serve as an on-ramp for its main board.<sup>7</sup> In this way, the SME exchange can serve as a business development tool for the main board itself. All three exchanges were at least partly motivated by the prospect of generating listings for their main boards.

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iv In October 2016, the Jamaican legislature passed the Income Tax (Amendment) Act, which maintained the tax incentives.

v This consideration is especially important if the SME exchange's low listing fees are made possible by subsidies from the main exchange. For more, see Alison Harwood and Tanya Konidaris, "SME Exchanges in Emerging Market Economies: A Stocktaking of Development Practices," Policy Research Working Paper No. 7160 (Washington, DC: World Bank Group), 2015, p. 14.

There are four possible approaches that an SME exchange can take to graduations. First, the exchange can require firms to graduate once they meet certain criteria. Second, the exchange can encourage firms to graduate, but stop short of requiring it. Third, the exchange can simply permit firms to graduate, but not actively encourage it. Fourth, the exchange may not permit graduations at all. If the exchange's goal is to serve as an incubator—that is, to prepare firms for listing on the main board—it may favor one of the first two approaches.

Both the BSE SME Platform and Jamaica's Junior Market require firms to graduate once they meet certain criteria. However, the two exchanges differ in terms of what criteria they use as well as how automatically the requirements kick in. Firms on Jamaica's Junior Market are expected to graduate within ten years of listing—so even if these firms do nothing, they will eventually be compelled to graduate. By contrast, firms on the BSE SME Platform will only be compelled to graduate if they take certain actions first—specifically, if they decide to issue additional shares that will increase their paid-up capital above a certain amount. South Africa's AltX allows graduations but does not require or actively encourage them. Firms may decide for themselves whether to stay or graduate, provided they can meet the main board's listing criteria and fees.

On all three SME exchanges, a majority of surveyed firms either do not intend to graduate or are ambivalent about doing so. On the BSE SME Platform, just 8 percent of surveyed firms intend to graduate in the next two years; on Jamaica's Junior Market, only 15 percent do. On South Africa's AltX, the proportion is one-third. Firms that wish to stay on their respective SME exchanges largely give the same reasons: satisfaction with their ability to raise funds on the SME exchange, lower fees and compliance costs (including, in Jamaica, tax breaks), and less demanding investors. The calculation these firms appear to be making is that the main boards do not offer enough in the way of prospective additional benefits to justify incurring certain additional costs.

That so few firms wish to graduate voluntarily may argue for compelling or at least persuading firms to graduate, at least for exchanges that wish to generate listings for their main boards. On the other hand, South Africa's AltX does not require graduations and yet it has the highest proportion of hopeful graduates among the three exchanges. This suggests that other factors are at play. Possibly, an SME exchange's graduation rate is also influenced by the types of firms that list, and not just the policies that the exchange sets.

Exchanges that want to boost graduations may wish to explore whether providing firms with additional technical assistance post-listing would address their concerns and make them more willing to graduate voluntarily. Such assistance might focus on managing investor relations (since some firms expressed concern that investors on the main board would be too demanding) or on cost-efficient compliance (since some firms worried about their ability to handle the additional fees and compliance costs).

Firms that hope to graduate are motivated by both financial and reputational considerations. The surveyed firms on the BSE SME Platform and South Africa's AltX look forward to a broader investor base, a more visible profile, and greater share liquidity. The surveyed firms on Jamaica's Junior Market are motivated primarily by reputation: they wish to be seen as mature, established firms, and hope that graduation will raise their profiles. If an exchange wants to persuade firms to graduate, it might do so by appealing to firms' financial and reputational considerations.

Over the past decade and a half, an increasing number of stock exchanges across emerging-market and developing economies have set up dedicated boards or market segments for small and medium-sized enterprises (SMEs)—there are now over 20 such SME boards. Many of these initiatives have taken their inspiration from successful “alternative” markets in advanced economies, most notably the London Stock Exchange’s Alternative Investment Market (AIM).<sup>8</sup> Motives for setting up these SME boards in emerging-market and developing economies include expanding SMEs’ access to often-scarce, longer-term finance as well as providing a “feeder exchange” for later listings on the stock exchange’s main board.<sup>9</sup>

SMEs can play an important role in the private-sector development of emerging-market and developing economies. According to analysis by Ayyagari, Beck, and Demirgüç-Kunt (2003), formal micro-, small-, and medium-sized enterprises (MSMEs) accounted for approximately 45 percent of employment and 33 percent of GDP in developing countries.<sup>10</sup> Despite their economic importance, however, SMEs often struggle to access financing. In a joint report, the IMF, OECD, and World Bank (2015) estimate the credit gap for SMEs in developing countries at around \$1 trillion.<sup>11</sup> According to the IFC (2013), access to finance is the most significant constraint to SMEs’ growth in middle-income economies and ranks second among business constraints in low-income countries (after access to electricity).<sup>12</sup>

Since the global financial crisis, SME access to finance has become further constrained, due in part to bank deleveraging. Demirgüç-Kunt, Martínez, and Tressel (2015) examine the capital structure of 277,000 firms in 79 countries from 2004 to 2011. They find that in the aftermath of the crisis, firms’ leverage and debt maturity declined across the board. By some measures, SMEs in developing countries were hit hardest. For example, SMEs in developing countries saw the ratio of long-term debt to total assets decline by 2.3 percent.<sup>13</sup> The adoption of stricter prudential regulations may also play a role. In order to reduce maturity-transformation risks, Basel III requires banks to set aside additional capital for long-term. This may disincentivize lending at the margin.<sup>14</sup>

In response to these challenges, policymaking and industry bodies have sought out alternatives to traditional bank financing for SMEs, particularly in accessing scarcer and more costly medium- to long-term finance. According to the OECD (2015), these efforts have aimed to address long-standing financial access constraints, exacerbated by the global financial crisis. They also have aimed to identify more appropriate funding vehicles for SMEs with high-growth potential.<sup>15</sup> Many non-bank financing alternatives are being explored, including financial leasing and other forms of asset-based financing, private equity (including angel investing and venture capital), and capital markets finance including public equity listings.<sup>16</sup>



As empirical research by the World Bank (2014) and others have made clear, public equity financing is most appropriate for only a particular subset of SMEs.<sup>17</sup> Harwood and Konidaris (2015) observe that most SME exchanges target fast-growing SMEs.<sup>18</sup> The OECD (2015) posits that equity financing is most appropriate for young SMEs that have strong growth prospects.<sup>19</sup> According to this line of reasoning, SME owners will give up privacy and control only if the prospective rewards for doing so are substantial.<sup>vi</sup> Nassr and Wehinger (2016) argue that equity financing may be more suitable than debt financing for SMEs that lack collateral, have negative or irregular cash flows, or require longer maturities for their investments to pay off.<sup>20</sup> The OECD (2016) notes that SMEs seeking public-equity financing must be sufficiently institutionalized to handle the reporting and corporate governance requirements.<sup>21</sup>

Some SMEs may be able to list on the main boards of their countries' exchanges. The World Federation of Exchanges (2016) estimates there are 6,000 SMEs listed on the main boards of its member exchanges, representing nearly half of all listed companies, in both developing and developed economies.<sup>vii</sup> However, according to Nassr and Wehinger (2016), many SMEs may find the costs of listing on the main boards to be "discouragingly high."<sup>22</sup> These costs include the initial and on-going listing fees, as well as indirect costs associated with meeting the reporting requirements for listed firms.

The WFE (2015) reports that almost half of its member exchanges now have dedicated SME boards or exchanges.<sup>23</sup> However, the existing literature underlines that the degree to which these SME boards can truly contribute to closing the SME financing gap remains an open question. Harwood and Konidaris (2015) caution that emerging-market and developing economies need to carefully consider whether an SME exchange represents a viable solution to the SME financing gap in their own economies, given the local context.<sup>24</sup> As the World Bank (2014) observes, the fraction of SMEs served by public equity markets is typically very small, even in advanced economies. It notes that in the European Union in 2010, there were 4,000 listed microcap companies, which is equivalent to just one percent of the region's medium enterprises and an even smaller percentage all SMEs.<sup>25</sup>

In addition, many stock exchanges in emerging-market and developing economies already struggle with low listings, small market capitalizations, and illiquidity—issues that are likely to be worse on SME boards in these economies. Indeed, some markets have already been undone by them: Nair and Kaicker (2009) note the failure of the Over-the-Counter Exchange of India, which they ascribe to, among other things, low listings and the lack of interest among institutional investors.<sup>26</sup> It may be that not all countries have enough high-growth SMEs suitable for capital-market financing to justify the creation of such exchanges. Moreover, government, donor, and other resources might be more productively devoted to advancing financial inclusion through other means—or to interventions outside of financial development altogether.

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vi It should be noted that SMEs may choose to list for reasons other than, or in addition to, raising capital. These reasons may include raising brand or product visibility with new and existing markets or attaining greater credibility and efficiency by adopting financial reporting requirements and increasing transparency. Some firms that choose not to raise capital on listing do seek to better position themselves to raise bank and other sources of finance at a later point.

vii The WFE used microcaps (defined by the WFE as firms with market capitalizations of less than US\$65 million) as a rough proxy for SMEs. See World Federation of Exchanges, "WFE Report on SME Exchanges," p.11. Available at <http://www.worldexchanges.org/home/index.php/files/18/Studies-Reports/310/WFEReportonSMEEExchanges.pdf>.

A handful of recent studies have sought to examine the efficacy of SME boards and have provided some recommendations on improving their performance as financing venues. Drawing on a World Bank workshop discussion of the experiences of SME exchanges in six emerging-market economies, Harwood and Konidaris (2015) devise a list of approaches that securities regulators could consider in setting up an SME exchange.<sup>viii</sup> These include a focus on high-growth firms, establishing a legal connection to a main board, outreach and awareness campaigns geared to SMEs and investors, and the use of regulated advisors to help bridge information gaps between issuers and investors.<sup>27</sup>

The WFE (2016) notes that reduced fees and listing requirements are often seen as one of the core rationales for setting up separate SME boards, observing that “SME market models tend to have a strong focus on cost containment.”<sup>28</sup> Along similar lines, the International Organization of Securities Commissions (IOSCO) recommends that national capital markets reduce listing and trading fees for SMEs and consider funding some portion of their IPO costs through an SME agency or other government body.<sup>29</sup>

Indirect costs related to meeting listing requirements, such as financial disclosure and governance requirements, are thought to be a significant obstacle to SMEs’ accessing public equity markets. The IOSCO study (2015) recommends exempting SMEs from certain disclosure requirements—reasoning that reduced issuer disclosure standards do not necessarily translate to reduced investor protection.<sup>30</sup> In contrast, Harwood and Konidaris (2015) advise against reducing disclosure content as a way to attract SME listings. Instead, they recommend reducing disclosure frequency.<sup>31</sup> Shinozaki (2014) notes that, at least in East Asia, exchanges have limited scope to reduce listing requirements, as domestic securities legislation typically does not make special provision for SMEs.<sup>32</sup>

Harwood and Konidaris (2015) point out that certain prerequisites should be in place before a country launches an SME exchange or dedicated board. These prerequisites include, above all, a sizeable supply of growth-oriented SMEs willing to issue public equity, as well as investors willing to buy their shares.<sup>33</sup> Echoing this point, Nassr and Wehinger (2016) argue that the “lack of equity culture and awareness has a significant negative impact on both the demand and the supply side of SME equity markets, limits their depth and breadth and restricts participation.”<sup>34</sup> Market prerequisites should be underpinned by a supportive political, legal, and regulatory context and government commitment. Harwood and Konidaris conclude that successfully developing an SME exchange is particularly difficult in emerging economies, where SMEs tend to be smaller than in developed economies.<sup>35</sup> They also recommend policies that encourage SMEs to access alternative financing methods such as private equity and venture capital as a first step, as well as allowing SMEs to issue equity as private placements.<sup>36</sup> On a similar note, Shinozaki (2014) reports that Malaysia’s experience with its SME market led it to conclude that an even earlier stage “preparatory market” was needed, as many SMEs are not even able to meet the SME market’s relaxed listing requirements and fees.<sup>37</sup>

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viii The exchanges that the paper focuses on are NSE India Emerge (India), JSE AltX (South Africa), GreTai Securities Market (Taipei) BM&FBOVESPA Bovespa Mais (Brazil), WSE NewConnect (Poland), BIST ECM (Turkey), and TSX Venture Exchange (Canada).

If they are serving their purpose, SME stock exchanges or dedicated market segments should facilitate investment in productive, growing SMEs, contributing toward job creation and economic growth. Past studies have shown a strong relationship between stock market development and economic growth in developing countries. As Levine (1991) theorizes, stock markets contribute to economic growth by incentivizing investors to enter into long-term investments by making it easier for them to exit at any time.<sup>38</sup> Levine (1996) explains in a later summary piece, “many profitable investments require a long-term commitment of capital, but investors are often reluctant to relinquish control of their savings for long periods. Liquid equity markets make investment less risky—and more attractive—because they allow savers to acquire an asset—equity—and to sell it quickly and cheaply if they need to access their savings or alter their portfolios.” Later empirical studies by Levine and Zervos (1998) and Beck and Levine (2004) provide econometric evidence for the contribution of stock market development to economic growth.<sup>ix</sup>

To date, the relationship between SME boards and economic development has not been studied to the same degree, and yet it may be a fertile area for future research, particularly given the role high-growth potential SMEs in strategic sectors can play in job growth and economic development. Peterhoff et al. estimate that expanding SME access to capital markets financing could increase SMEs’ contributions to GDP by 0.1 to 0.2 percent and generate hundreds of thousands of new jobs.<sup>39</sup> However, these are only forecasts. Future studies may usefully seek to understand the challenges preventing even those firms that may be good candidates to list from listing on SME boards as well as the efficacy of SME exchanges themselves as conduits of capital.

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ix Levine and Zervos (1998) studied the relationship between stock market development and economic growth, analyzing data from 47 countries during the period 1976-1993. They find that greater stock market liquidity is associated with higher current and future economic growth rates, including both higher capital accumulation and higher productivity growth. In a later study, Beck and Levine (2004) examine panel data for 40 countries from 1976 to 1998, using 5-year periods to smooth out business-cycle effects. They find that the balance of evidence shows that banks and stock markets contribute independently to economic growth, indicating that stock markets compliment banks by providing different services. See Ross Levine and Sara Zervos, “Stocks, Banks, and Economic Growth,” *The American Economic Review*, Vol. 88, No. 3 (1998), pp. 537-558; and Thorsten Beck and Ross Levine, “Stock Markets, Banks, and Growth: Panel Evidence,” *Journal of Banking and Finance*, 28 (2004), pp. 423-442.

### Box 3. What are SMEs?

According to the World Bank (2014), “for ‘SME’ to be a meaningful category of enterprises, it should be a group of firms that is specifically differentiated from others by the way that it experiences particular policy, institutional, or market failures or the way it benefits the economy or the poor.”<sup>40</sup> However, there is no universally-accepted definition of what constitutes an SME. Even within the World Bank Group itself, definitions vary from project to project.<sup>x</sup>

National definitions vary widely. According to Kushnir, Mirmulstein, and Ramalho (2010), countries employ a variety of indicators and thresholds. Countries most commonly define SMEs in terms of the number of employees, but a significant minority set benchmarks against other attributes, such as annual turnover (revenue), annual investment, and balance-sheet size.<sup>41</sup> Kushnir et al. (2010) report that of the 132 countries covered by the IFC’s MSME Country Indicators, a third (46 countries) define MSMEs as having 250 employees or less. Twenty-nine countries use a definition other than workforce size. Even within a country, a single definition might not prevail between government agencies or across all industries. The IFC’s MSME Country Indicators (2010) show that 11 of the surveyed countries differentiate by sector.<sup>42</sup>

The failure to coalesce around a single definition for SMEs complicates policymaking and analysis. As Kushnir (2010) observes, “a universal MSME definition would ease the design of loans, investments, grants, and statistical research.” In spite of these complications, however, a tailored approach to defining SMEs may nevertheless be the most appropriate, owing to the diversity of emerging-market and developing economies.<sup>xi</sup>

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- x The International Finance Corporation and the Multilateral Investment Guarantee Agency formally define SMEs as those firms that fulfill at least two of three criteria: “having more than 10 and fewer than 300 employees; having between \$100,000 and \$15 million in sales; and having between \$100,000 and \$15 million in assets.” The World Bank employs different definitions for its Enterprise Survey, its research, and for individual projects. The World Bank’s Independent Evaluation Group has criticized the use of a single standard for not being “contextually adapted by income level of country, size of economy, sector, or other criteria.” See Independent Evaluation Group, “The Big Business of Small Enterprises,” 2014, p. 16.
- xi As Kushnir ultimately concludes, “economies have diverse structural, cultural, and political reasons to adopt different definitions of MSMEs that would run counter to any universally-agreed definition.” See Kushnir, “A Universal Definition of Small Enterprise: A Procrustean Bed for SMEs?” World Bank, 2010.

## INDIA: THE BOMBAY STOCK EXCHANGE'S SME PLATFORM

In India, SMEs contribute to about 40 percent of the country's GDP and employ a quarter of the labor force. Over the past several years, Indian policymakers have given increased priority to advancing financial inclusion, for businesses and households, as a catalyst for growth and socio-economic development. Recent financial access initiatives have included the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households established in 2013, Prime Minister Narendra Modi's national Financial Inclusion Mission, and a recent \$500 million World Bank loan for a new MSME Growth Innovation and Inclusive Finance Project.

While SMEs that met listing requirements were previously able to issue shares on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE), over the last decade Indian regulators and the stock exchanges themselves have worked to further open public equity financing to SMEs. In 2008, the Securities Exchange Board of India (SEBI) introduced a framework for setting up dedicated SME market segments.<sup>43</sup> The BSE established its SME Platform in September 2011. The BSE's main competitor, the younger NSE, introduced its SME exchange, Emerge, a year later, in September 2012.

Both exchanges have sought to apply lessons learned from India's first experiment with market-based equity financing for SMEs, the Over-the-Counter Exchange of India (OTCEI), set up in the early 1990s. Nair and Kaiker (2009) attribute the OTCEI's inability to take off to a host of factors, including inopportune timing (it commenced operations during a bear market), scant marketing, low listing quality, and lack of interest from institutional investors and potential issuers alike.<sup>44</sup> Moreover, according to Jain et al. (2013), the new SME boards have taken a vastly different approach than the OTCEI by, first, being housed within the main stock exchanges and allowing for graduation to the stock exchanges' main market segments and, second, by providing listing SMEs 100 percent underwriting of their initial issuance.<sup>xii</sup>

For this study, we chose to focus on the BSE SME Platform, which has achieved greater progress in attracting listings over its first few years of operation than the NSE Emerge. By the end of 2015, the BSE SME Platform had attained 119 listings, compared with just 10 on Emerge. While the BSE's board had a brief head start, it also managed a robust outreach campaign, which has included hosting more than 450 seminars to educate SME owners on the benefits of listing.<sup>45</sup>

The BSE SME Platform also merits study because it has adopted what have become common features of SME exchanges worldwide. These features include reduced listing fees and streamlined requirements compared with the main board—as well as the use of authorized intermediaries to guide firms through the listing process. Interestingly, the BSE SME Platform permits firms to voluntarily graduate to the BSE's main market after being listed for two years. And yet this exchange also requires firms to graduate once they reach certain thresholds. These provisions allowed us to study how firms view the benefits and disadvantages of migration from an SME segment to an exchange's main board.

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xii See Jain, R.K., Avdesh Kumar Shukla and Kaushiki Singh, "SME Financing through IPOs: An Overview," *Reserve Bank of India Occasional Papers*, Vol. 34, No. 1 & 2: 2013. In *SME Financing Through Capital Markets*, IOSCO (2015) also reports that India has achieved one of the lowest cost structures for SME IPOs, at 0.5 percent of capital raised compared to, for example, 8 to 20 percent in Malaysia or 20 to 30 percent in Singapore.

At the time we conducted our survey in 2016, there were 152 firms listed on the BSE SME Platform.<sup>46</sup> Though the board was not established to develop any particular sector of the economy, it has tended to attract the most listings from manufacturing and utilities companies, and together these sectors make up more than half of current listings. The market capitalization of listed firms ranged, at the time of our survey, from US\$239,000 to US\$107.5 million with a median of US\$2.6 million, and total market capitalization for the SME Platform was just over US\$1 billion.

## I. THE DECISION TO LIST

*In Section I, we explore the listing aims of surveyed Indian SMEs on the BSE before turning, in the next sections, to evaluating how these aims stack up with their experiences, both positive and negative, as listed firms. This section compares the listing motives of SMEs on the BSE's main market and those on the SME Platform, as well as how these square with the BSE's original aims for setting up the SME Platform and current motives for operating it. In this way, we aim to more fully understand the intended role of the SME Platform and whether it meets the financing and other aims of the SMEs that list on it.*

Surveyed SMEs listed primarily to improve their access to finance—both directly and indirectly. Firms on the BSE's main board and SME Platform shared the same top reason for listing: enhancing creditworthiness (mentioned by 79 percent of SMEs on the main board and just over two-thirds of SME Platform firms). A related financing motive, the ability to raise lower-cost capital, was a second-ranking listing aim for SMEs, with slightly more significance for firms on the SME Platform. One-fifth of main board firms and a quarter of SME Platform firms gave another closely related reason for listing—improving the ability to raise additional finance including from banks.

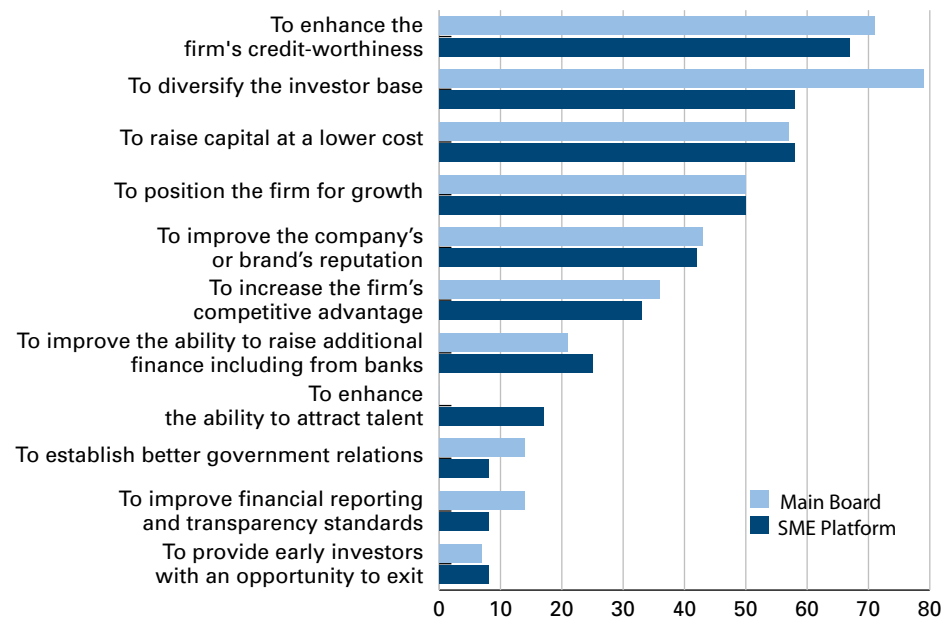
It is not surprising that surveyed SMEs listed on Indian equity markets said that a desire to improve financial access was a main motive for going public. SMEs generally have more difficult and costly access to bank and other medium- to long-term finance than large firms do, especially in developing countries. Banerjee and Duflo showed empirically that Indian banks, in their lending decisions, often did not take adequate account of SMEs' profit track records and growth potential.<sup>47</sup> Recognizing that SMEs are credit constrained, the current Indian government's financial inclusion program has introduced measures that seek to address banks' information asymmetries and improve the ability of SMEs to access bank finance.

Our survey findings show that, so far, growth-oriented SMEs are not making extensive use of listing as a means of private equity (PE) exit. Although the BSE SME Platform actively markets itself as an exit for early-stage investors, such exits have comprised just 5 percent of new listings over the past five years.<sup>48</sup> Among surveyed firms on both the main and SME market segments, providing early-stage investors with the opportunity to exit was one of the least common reasons driving a listing decision (shared by just 8 percent of firms). Investors can find it difficult to exit and get other investors to take up stakes. While the value of PE exits in India increased significantly in 2015, the ability to exit continued to pose challenges including due to mismatches between prices investors are willing to pay for stakes and prices at which invested-capital is willing to sell.<sup>49</sup>

For firms on the main board, diversifying the investor base shared the top motive rank with enhancing creditworthiness. Diversifying the investor base still ranked highly for firms on the SME Platform. Attracting adequate investor participation is critical to the success of any capital market and an earlier over-the-counter market for SMEs set up in India in 1992, the Over-the-Counter Exchange of India (OTCEI), failed to take off due to lack of sufficient interest by institutional investors.<sup>50</sup> The tendency of pension funds and other institutional investors, in general, to prefer to invest in larger firms can pose a significant challenge to SME boards.<sup>51</sup>

**Figure 1. Main reasons Indian SMEs list**

Percent of surveyed firms that include each factor as a top motivation



Source: Milken Institute Center for Financial Markets (CFM) survey of SMEs in India

Non-financial access reasons were secondary motives for listing on the BSE. Around half of firms on the BSE's SME Platform and the main board cited positioning themselves for growth as a main reason for listing. Raising awareness of the firm's brand or boosting reputation was important to just over four in ten of SMEs on both of the BSE's boards. This may be explained by SMEs generally being in an earlier growth phase of their business life cycles than larger firms—and therefore actively seeking to raise their visibility with new target customers.

Overall, our findings show stock exchange managers correctly perceive the main drivers motivating SMEs to list on the BSE. However, there are exceptions. Stock exchange managers may overestimate the importance that current and prospective listed SMEs attribute to improved financial reporting and transparency as a beneficial outcome from going public. Very few listed firms (14 percent on the main board and 8 percent on the SME Platform) pointed to the opportunity to improve financial reporting and transparency standards as an important reason for listing. (Ironically, of course, these requirements enable firms to meet their aims of enhancing creditworthiness and attracting new investors.) In contrast, the BSE thought this would be critical to SMEs' decision to list. Stock exchanges could engage in more education and outreach with current and prospective listed firms on this aspect of a listing (see also Section V).

SMEs' top motives for listing are broadly in synch with the BSE's original aims for setting up the SME Platform and its current motives for operating it. Among the BSE's most important motives for setting up the SME Platform were increasing SMEs' access to scarce costly medium- to long-term financing, as well as helping firms grow. However, the BSE was also responding to a concern at the time preceding the SME Platform launch that many SMEs were overleveraged. Therefore, the SME Platform was set up to encourage a shift away from debt financing and to provide easier access to equity finance. The timing of the SME Platform's launch was also set to capitalize on a period of high economic growth in India. In general, where a stock exchange remains closely attuned to the different reasons SMEs list—and choose the SME Platform over the main board—it may be able to more easily and closely target candidates for future listing.

## II. LISTED SMES AND ACCESS TO FINANCE

*In Section II, we first look at whether surveyed firms raised capital upon listing. For those that did, we examine their use of IPO proceeds. We find that nearly all surveyed firms raised capital upon listing, and that these firms directed their proceeds toward a variety of short- and long-term funding needs. Next, we analyze whether listing improved firms' access to other sources of finance. We find that subsequent to listing, a majority of surveyed firms raised additional medium- to long-term finance, mostly from banks—including all firms that listed specifically in order to improve their access to finance.*

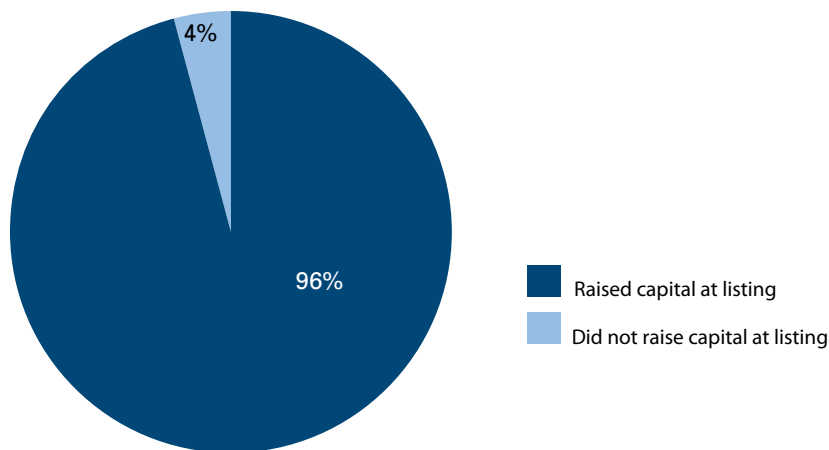
All but one of the surveyed firms raised capital upon listing (see Figure 2). Somewhat surprisingly, there is no strong correlation between the amount raised at listing and selection of main board over SME board. Among participating listed firms, the capital raised at IPO ranged widely from INR1.5m (about \$33,400) for a main board firm that listed in 2000 to INR400m (just over \$6.5m) for an SME Platform firm that listed in 2014.<sup>52</sup>

There also does not appear to be any strong relationship between amounts raised by surveyed firms listing at the beginning compared with the end of the 2000-16 period for IPOs launched by surveyed SMEs. The two firms raising capital in amounts at the lower end of the range for IPO proceeds listed on the main board and their IPOs spanned the 2000-16 time period. Of the six SMEs in our sample whose IPO proceeds exceeded \$2 million, half of them listed on the SME Platform and their listings spanned 2000-14.



## Figure 2. Did firms raise capital at time of listing?

Percent of all surveyed listed firms



Source: Milken Institute CFM survey of SMEs in India

Firms typically used these proceeds for multiple purposes, although there are some prominent patterns (see Figure 3). For firms on both boards, two of the three most common uses of IPO proceeds were for long-term investments: investments in factory or equipment and investments in the development and launch of new products.

However, firms on the main board were more likely to use their IPO proceeds for long-term investments than were firms on the SME Platform. Nearly 70 percent of SMEs on the main board included investment in factory and equipment among their uses for capital raised—compared with half of firms listed on the SME Platform. Similarly, nearly 70 percent of SMEs that listed on the main board used some of the funds raised to develop and launch new products or services—compared with just a third of firms on the SME Platform.

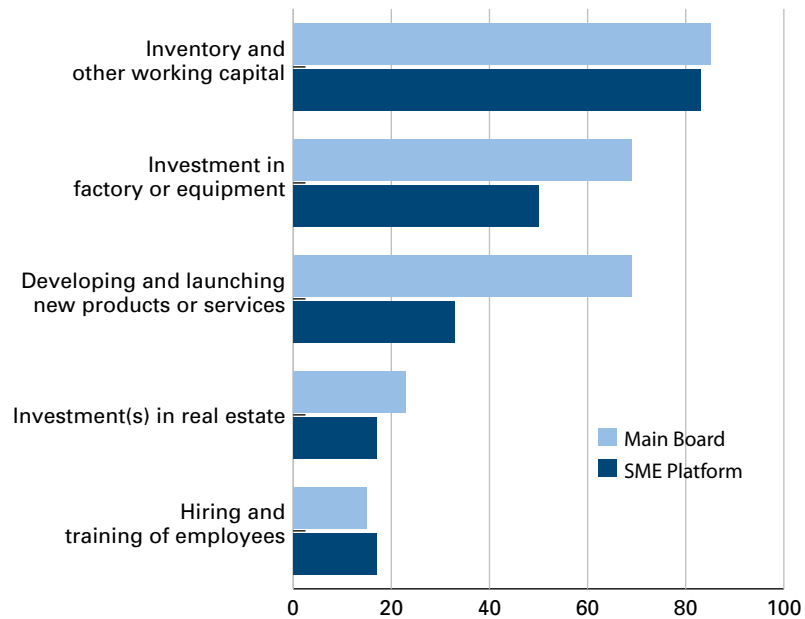
Firms on both boards most frequently reported using some of the funds raised through an IPO for inventory and other working capital—an unsurprising finding, as these are typical ongoing costs for SMEs, particularly for manufacturing firms. However, just three firms (one on the main board and two on the SME Platform) reported using their IPO proceeds exclusively for this purpose. Of these three firms, just one reported that it had not secured any additional post-IPO financing.

Manufacturing and technology firms were the most likely to use IPO proceeds to invest in factory or equipment, while technology firms frequently used them to fund new products or services. Manufacturing firms are often among the most capital-intensive, so these investments are to be expected. The use of IPO proceeds to finance working capital was common across nearly all sectors. Among the 13 firms that stated they listed in order to grow, only 46 percent invested in factory or equipment, though 62 percent invested in new products or services.

It is not surprising that listed SMEs use their IPO proceeds to fund both short- and long-term needs. High-growth SMEs, especially in manufacturing, require ample working capital to maintain liquidity. Further, as these SMEs grow, so do their fixed-asset investment needs relative to their working capital needs.<sup>53</sup> In an early assessment of India’s SME exchanges, the Reserve Bank of India (RBI) looked at how listing firms planned to use their IPO proceeds. They found that firms intended to use the proceeds “for meeting working capital requirements, augmenting capital base, general corporate purposes, enhancement of margin requirements and expansion of businesses,” as well as to reduce their debt.<sup>xiii</sup>

**Figure 3. Use of IPO proceeds by listing venue**

Percent of firms that used some IPO proceeds to fund this expenditure



Source: Milken Institute CFM survey of SMEs in India

An equity listing may facilitate greater access to other avenues of medium- to long-term financing, at least for many firms. Nearly every firm that was satisfied with its decision to list—on both the main board and the SME platform—cited improved access to finance as one of the main reasons why. Improving access to finance for SMEs was among the BSE’s rationales for creating the SME Platform.

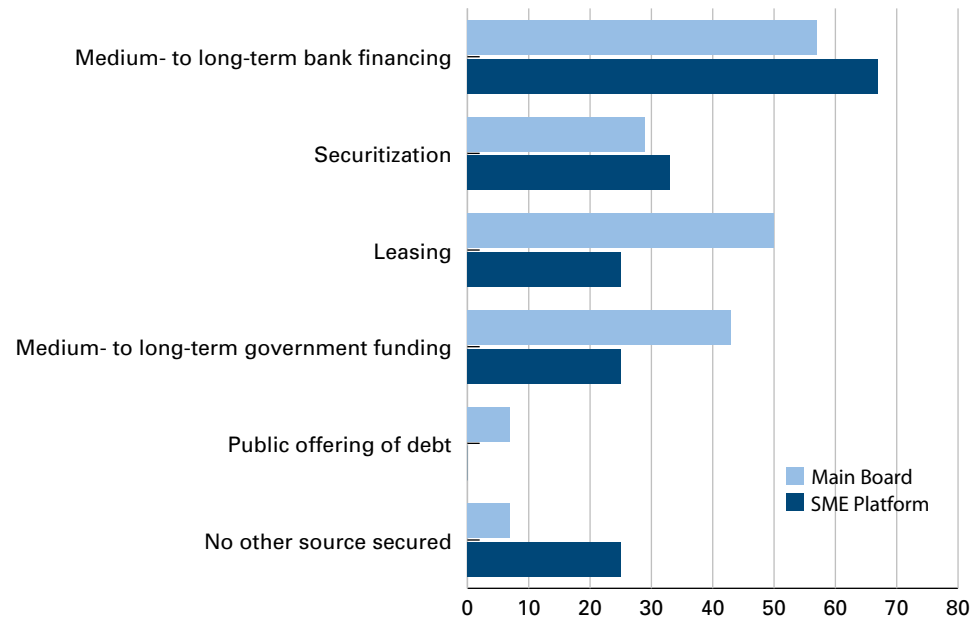
Notably, a majority of surveyed firms were able to raise additional medium- to long-term capital from other sources post-listing. Banks were the most common source of post-IPO finance for firms on both boards (see Figure 4). After banks, firms on the main board most frequently turned to leasing and then to government funds, whereas firms on the SME Platform most frequently turned to securitization. Just 7 percent of firms on the main board reported not securing any additional post-IPO financing at all, while fully one quarter of firms on the SME Platform reported the same.

xiii The RBI’s early findings partly overlap with those of our survey, although they did not further specify firms’ use of funds or rank the importance of these uses. See R.K. Jain, Avdesh Kumar Shukla, and Kaushiki Singh, “SME Financing through IPOs: An Overview,” *Reserve Bank of India Occasional Papers*, Vol. 34, No. 1 & 2 (2013), p. 147. Available at: [https://www.rbi.org.in/scripts/bs\\_viewcontent.aspx?ld=3055](https://www.rbi.org.in/scripts/bs_viewcontent.aspx?ld=3055).

Moreover, all six firms that listed to improve their access to additional bank and other finance actually secured additional medium- to long-term non-equity financing post-IPO. Four of these firms—including all three firms listed on the SME Platform—accessed medium- to long-term bank financing. The other two firms accessed government funds or raised additional finance through securitization or leasing. One of these two firms that had not accessed bank financing had only just listed in 2016; both were listed on the main board.

**Figure 4. How did listed firms access medium- to long-term finance after going public?**

Percent of firms that raised this type of financing post-IPO



Source: Milken Institute CFM survey of SMEs in India

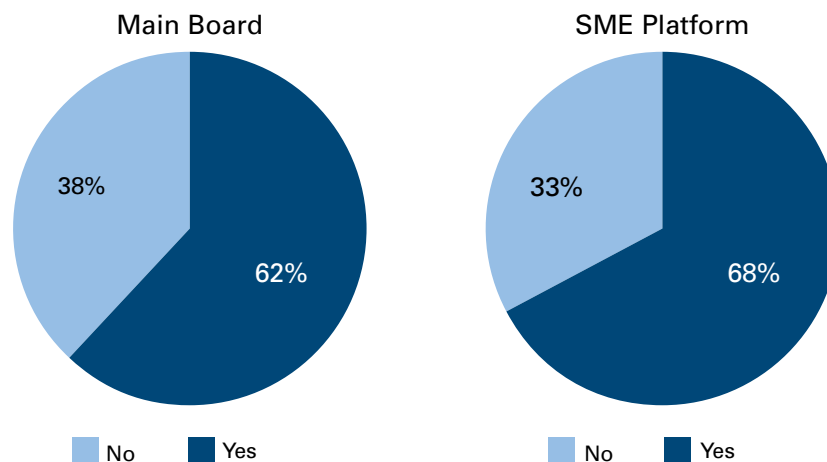
These findings may support the idea that when a firm improves corporate governance and financial reporting to meet listing criteria, it can also improve its ability to access financing from banks and other sources. For the same reason, it would seem plausible that listed firms access bank financing on better terms than their unlisted competitors. However, these survey findings must be interpreted cautiously. It could be the case that at least some of the firms deciding to list would be high-growth potential firms and therefore already better placed to raise bank and other finance than many firms that do not seek to list.

### III. ASSESSING THE LISTING EXPERIENCE

*In Section III, we look at whether, based on their experience, firms would make the same decision to list if they had to do it all over again. This section also details the aspects of listing that have met with or exceeded firms' expectations before turning to the causes of discontent. As discussed below, SMEs that listed on the BSE SME Platform tended to have their expectations met or exceeded more often than SMEs joining the main board. In a related finding, SMEs that listed on the BSE main market have different complaints than those that listed on the SME Platform.*

Nearly every firm that was happy with its decision to list—on both the main board and the SME Platform—cited improved access to finance as one of the main reasons why. As discussed above in Sections I and II, a variety of goals related to enhancing access to finance motivate Indian firms to pursue a public listing (more so than is the case for listed SMEs in South Africa and Jamaica). It is perhaps unsurprising then that an improved ability to raise capital was key to why a majority of listed Indian SMEs' overall experience has been positive. In addition to access to finance, a number of firms on both boards also pointed to positive effects on their visibility and reputation as well as improved business operations as causes of their satisfaction with their original listing decision (see Box 4 below).

**Figure 5. Would SMEs choose to list again?**  
Percentage of surveyed listed SMEs



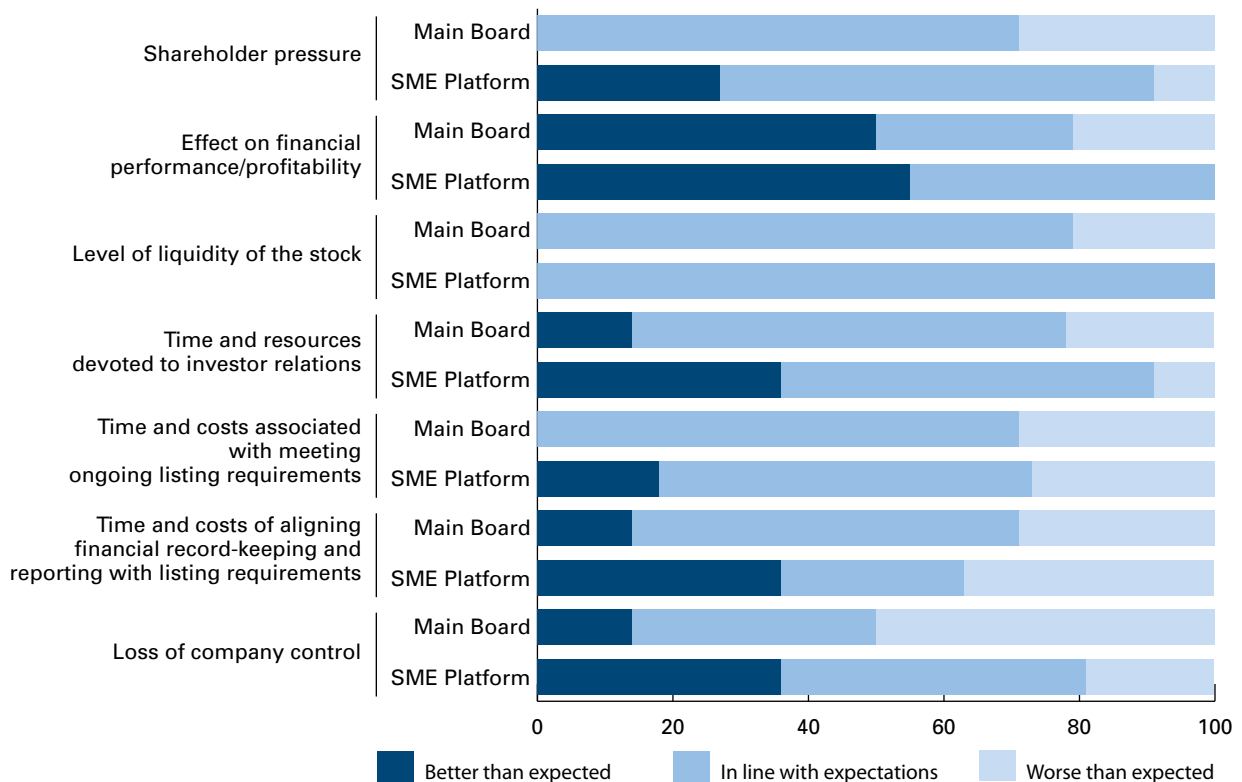
Source: Milken Institute CFM survey of SMEs in India

The fact that firms on the main board and the SME Platform both experience these benefits has interesting implications. First, it is further evidence that compliance with the disclosure and governance requirements of a public equity listing contributes to improving the creditworthiness of firms and, thereby, increases their access to finance. The consistency across boards, though, also supports the idea that these benefits can accrue to firms listed on SME boards with reduced disclosure frequency. While firms on the BSE's main market report quarterly, those on the SME Platform submit semi-annual reports, though the content requirements are the same across both boards. Despite reduced filing frequency, our findings suggest very little difference between boards in terms of the positive impact of listing on enhancing firms' financial access. This finding also indicates that a sufficient number of investors are comfortable enough with the reduced disclosure frequency to buy shares in firms listed on the SME Platform.

Across almost all categories, most SMEs on both boards report that the experience of becoming a listed company has been in line with or has exceeded their expectations. Notably, though, firms on the SME Platform report higher levels of satisfaction than their peers on the main market on a range of outcomes. This is the case, for example, with the effects of listing on financial performance and profitability. Majorities of firms on both boards report that this aspect of listing has exceeded their expectations. However, a fifth of SMEs listed on the main board reported that the impact on financial performance and profitability fell short of expectations, whereas no firm on the SME Platform said the same. (See Figure 6 below for these and other noteworthy findings on Indian firms' experience of being listed as compared to their pre-IPO expectations.)

Several factors suggest that the SME Platform does a better job mitigating the perceived drawbacks of listing SMEs compared to the main market. In particular, firms on the SME Platform rank their experience more positively in terms of the resources required to meet ongoing listing requirements, the resources devoted to investor relations, and pressure from shareholders. There is also a clear difference in how firms on the two boards experience the loss of company control upon becoming a public company. Half of the SMEs on the main board found the reality of being listed to be worse than expected on this front. Only 18 percent of companies on the SME board, however, felt the same way, while over a third found the experience on this factor to be better than they had expected prior to listing. Taken together, these findings likely reflect the important role played by authorized intermediaries in guiding firms through the listing process and their first years on the exchange, as described in greater detail below. It is possible also that shareholders on the main board may be more demanding than those on the SME segment, and this could be an area of interesting future research.

**Figure 6. Experience versus expectation for listed Indian SMEs**  
Key indicators compared across the SME Platform and the main board



Source: Milken Institute CFM survey of SMEs in India

Expectations for impact on share liquidity and investor interest were more likely to be met or exceeded on the SME Platform than the main board. All surveyed firms on the SME Platform found the liquidity of their shares to be in line with expectations prior to listing, while just under 80 percent of surveyed SMEs on the main board found that the resulting liquidity level met expectations. Similarly, all surveyed firms on the SME Platform found that interest from institutional investors met or exceeded expectations. Nearly 30 percent of SMEs on the main market, though, found that interest from institutional investors fell short of expectations. This difference between the two boards may again be a result of the additional handholding firms listing on the SME platform receive. It might also suggest, however, that SMEs on the main board are more concerned with trading activity than their counterparts on the SME Platform—or perhaps reflect lower expectations of the benefits of a public listing among firms that list on the SME-dedicated segment.

Still, SMEs on the main board clearly had more positive experiences in two categories we examined. First, 85 percent of SMEs on the main board noted that the coverage their shares had received from professional stock analysts had met or exceeded expectations, while 27 percent of firms on the SME Platform said that this aspect of listing had been worse than expected. These figures are fairly unsurprising, however, as a common challenge for SME boards is the lack of research coverage (which can contribute, among other factors, to low investor awareness).<sup>xiv</sup>

Second, a large percentage of firms on the SME Platform found the public scrutiny experienced as a listed company to be more negative than anticipated. Nearly 30 percent of firms of the SME segment had this experience, compared to only 7 percent on the main board. It is important to note that this finding was not due to the fact that companies were family-owned firms. Only a small fraction of surveyed firms on the SME Platform were family-owned, and their experience was mixed on this point. Instead, the dissatisfaction of about a third of firms on the SME segment on this factor may reflect a lack of awareness or psychological preparation for this aspect of listing.

Finally, among firms that regretted their listing altogether, the causes of dissatisfaction diverge in interesting ways between the main board and the SME Platform. In short, shareholder pressure and financial reporting requirements are more significant drawbacks for SMEs on the main market than they are for firms on the SME segment. Surveyed firms on the main board that would not list again mainly said this was because of shareholder pressure, loss of company control, and the resources required to meet reporting standards. None of the firms on the SME Platform that regretted their listing gave these reasons. Instead, they responded either vaguely or by noting that, after the initial capital raise, the additional benefits of listing did not materialize. Two implications follow from these results: first, again, that the SME Platform does a better job overall helping firms cope with the new pressures they experience as public companies and, second, that the reduced reporting frequency relieves an important burden for SMEs that go public.

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xiv To address this concern, the SME Platform directly commissions research on listed firms from third parties, and authorized intermediaries also produce research on firms they are assisting.

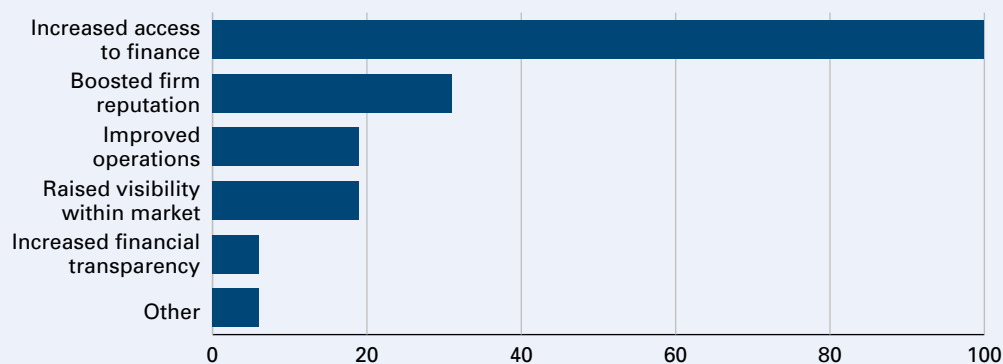
#### Box 4. Why firms would list again

Roughly two-thirds of surveyed firms on both boards were satisfied with their decision to list and would do so again. Every firm that was happy with its decision to list—on both the main board and the SME Platform—cited improved access to finance as one of the main reasons why. Some firms pointed directly to the funds they were able to raise by listing their shares. Other firms reported that they were happy with how their access to other sources of finance had improved since going public. One firm indicated that listing would improve its ability to raise financing from other sources by enabling it to reduce its leverage.

Several firms listed on the main board also noted that listing had enhanced their reputation or raised their profiles in their respective markets, though none of the firms listed on the SME Platform did so. A few firms listed on the SME Platform highlighted the improvements to their operations and organizational structure that resulted from listing. Finally, one firm on the main board pointed to the increased transparency in its financial reporting as a reason why it would list again.

#### Figure 7. Main reasons firms would list again

Percent of firms citing this as a main reason why they are satisfied with their decision to list



Source: Milken Institute CFM survey of SMEs in India

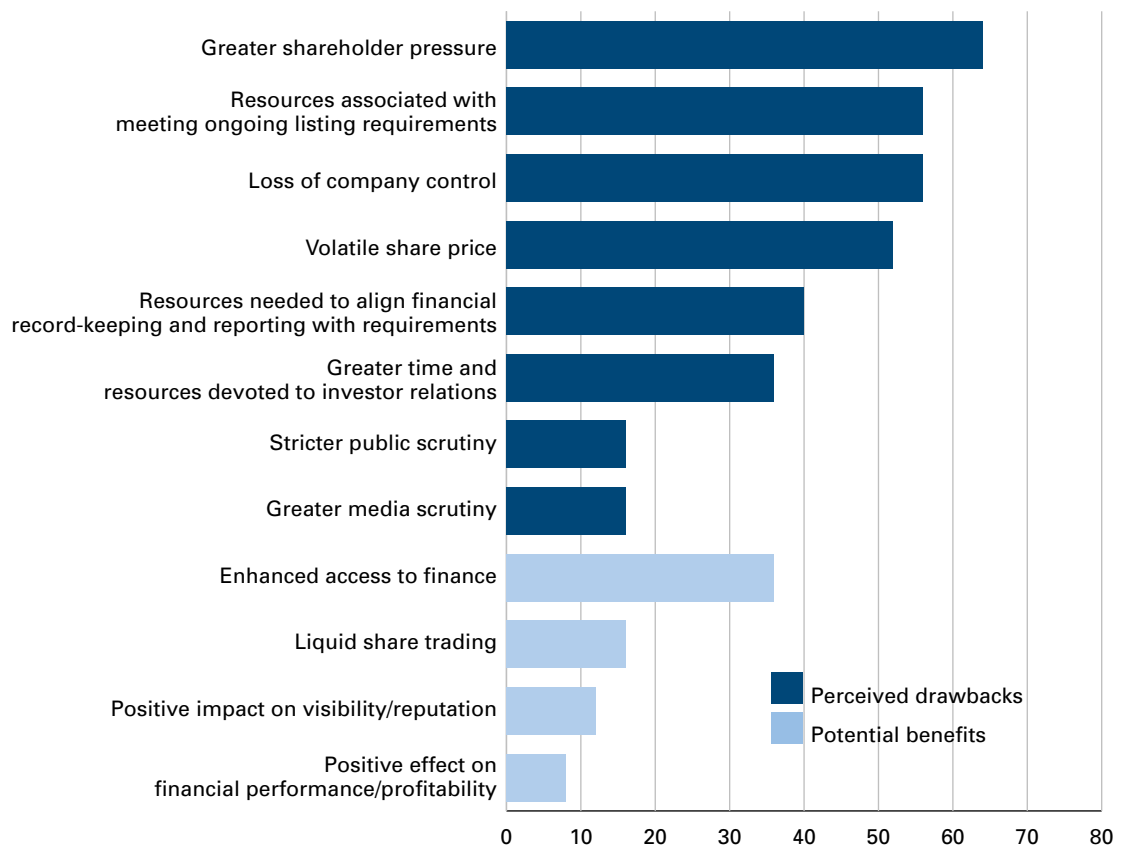
## IV. HOW UNLISTED FIRMS VIEW LISTING

*In Section IV, we review the perceptions unlisted firms have about becoming a public company. We also look at why firms that met listing requirements and considered a listing ultimately decided not to list and whether firms would consider a future listing. One of our core findings is that unlisted Indian SMEs associate going public more strongly with potential drawbacks than possible benefits. No surveyed, unlisted SMEs believed their firms would consider a listing in the future—a clear contrast between India and the two other countries in this study, South Africa and Jamaica.*

The most common negative association with listing among unlisted SMEs was greater shareholder pressure, as cited by 64 percent of participating unlisted firms. Just over half of the 25 surveyed unlisted firms including four of the five firms that had considered a listing but decided against it, associate becoming a public company with a loss of company control. Unsurprisingly, family-owned businesses were more likely to have this association, with 71 percent of unlisted, family-owned SMEs citing concern about loss of company control compared with 50 percent of non-family-owned firms. Majorities of unlisted SMEs also connected going public with the time and costs of meeting ongoing listing requirements and share-price volatility, both of which exchange officials believe unlisted firms would view as minor outcomes of listing. (Figure 8 below summarizes these perceptions.) In open-ended responses, unlisted firms also emphasized perceived drawbacks—namely, reporting and regulatory requirements, related compliance costs, and loss of company control.

**Figure 8. What unlisted SMEs associate with listing on a stock exchange**

Percentage of firms that hold this association



Source: Milken Institute CFM survey of SMEs in India

These negative impressions of what a public listing could mean, unsurprisingly, dampen the interest unlisted Indian SMEs have in considering a future listing. No surveyed unlisted SMEs in India were planning on pursuing a listing in the future. A fifth had ruled out the possibility altogether. The rest were simply unsure about the idea. These results contrast sharply with responses in South Africa and Jamaica, where unlisted firms have more positive views on going public. In South Africa, 19 percent of surveyed unlisted SMEs would consider listing in the future. In Jamaica, a very large percentage of surveyed firms—80 percent—said the same.



Interestingly, in India, some of the top concerns of unlisted SMEs may be overwrought—and may reflect impressions of the main board more than the younger SME Platform. For instance, 27 percent of surveyed firms that listed on the SME Platform found that shareholder pressure was less problematic than expected, while large majorities of listed firms on both boards found this outcome to be in line with expectations. Moreover, for over a third of firms listed on the SME Platform, the experience of listing turned out to be better than expected in terms of loss of company control. At the same time, the outcome most weakly associated with a listing among unlisted firms—improved financial performance and profitability—proved to be better than expected for a majority of surveyed firms listed on both market segments of the BSE.

Still, response from BSE exchange managers suggest that they may underestimate several widespread assumptions about listing among unlisted SMEs. In particular, exchange officials presumed that unlisted firms would view shareholder pressure and the expenses and time of meeting ongoing listing requirements as minor outcomes of listing. Exchange officials also anticipated unlisted firms would see improved financial performance as a minor outcome of listing. Considered alongside the evidence above, exchange officials may want to begin emphasizing these issues—and the reality of listed firms’ experiences on the SME Platform, in particular—more heavily in their communications with prospective companies. There may be an opportunity to tell a positive story that unlisted firms have not yet heard.

Of course, listing is not the right choice for all firms. Among surveyed firms that had considered a listing in the past, 58 percent were unable to move forward with a listing for the simple reason that they did not meet the listing requirements.<sup>xv</sup> On the other hand, those firms that considered a listing, met the requirements, but ultimately did not list most commonly reported that they had determined that listing was too expensive or that the listing requirements had entailed changing too many business processes. None of these firms cited a lack of information about listing as a reason affecting their decision. Among this group, several firms indicated that they would be more likely to consider listing in the future if the exchange further simplified listing requirements or if tax incentives were available to listed firms.

Whether or not these would be sound policies for the BSE to adopt is debatable. For their part, exchange officials did not believe they needed to change their standards or procedures to attract more listings.

## V. MAKING LISTING MORE ATTRACTIVE

*In Section V, we compare requirements and processes for listing on the BSE SME and main boards and we discuss the support that SMEs can and do access in going and staying public. We examine the changes that unlisted, yet qualifying SMEs themselves indicated in our survey would make it more likely that they would take their firms public. Although the BSE has considerably streamlined listing processes and documentation for a firm issuing shares on the SME Platform, we find that unlisted SMEs rank further simplification of listing procedures as a top change that would encourage them to consider listing.*

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xv Slightly over half of the unlisted firms that participated in our survey (13 of 25, Q11) had never previously considered listing on a stock exchange in the past.

*This section then looks at whether the available education, awareness and technical assistance programs are reaching SMEs to inform them of the potential benefits as well as the “how-to” nuts-and-bolts technical aspects of listing. We also look at the feedback from SMEs that took up the different kinds of assistance available and ask them specifically about its usefulness. We examine these issues from the perspective of both the SMEs accessing these services and the BSE itself. We find, notably, that unlisted, qualifying Indian SMEs lack understanding of how the listing process actually works and are unclear about the actual costs of going and staying public.*

Most SME exchanges seek to make the process of listing easier and less costly than the corresponding main board process. The BSE SME Platform is no exception. The BSE has lower listing thresholds and documentation requirements for an initial listing on the SME Platform. Although the BSE’s main market charges INR20,000 to join, there is no initial listing fee for the SME Platform.<sup>54</sup> Yet listing thresholds provide some room for maneuver for a subset of SMEs to choose between the SME and main boards: post-issue, paid-up capital must not exceed 25,000 rupees for SME Platform listings whereas the main board has a minimum post-issue, paid-up capital requirement of INR10,000.

Authorized intermediaries also assist firms going public and remain with the listed firm for a minimum of three years (see Box 5). For surveyed firms, the most important role authorized intermediaries provide is in helping them prepare IPO documents and ensuring their compliance with listing, disclosure, and governance requirements. In particular, the vast majority of surveyed, listed SMEs that had accessed assistance from authorized intermediaries in auditing their financial performance and preparing IPO documents found it very useful (87 percent and 93 percent, respectively). Sixty percent of participating SMEs that received assistance in ensuring compliance with listing, disclosure and governance requirements ranked this advisory work as very useful.

Despite the streamlined listing requirements and support available for shepherding an SME through the listing process and beyond (see below), further simplification of listing procedures is one of the two top changes that unlisted, qualifying SMEs said would encourage them to consider listing on the BSE (80 percent).<sup>xvi</sup> This finding may not be entirely unexpected given the organizational and procedural changes SMEs typically have to adopt to meet corporate governance and financial reporting standards in the course of going public.

The changes SMEs need to make to internal processes may be the most time intensive part of the listing process, regardless of whether other documentation requirements are streamlined or waived. Among surveyed firms, listing times were somewhat longer on the BSE’s SME Platform than on the main board. Companies that list on the SME Platform took ten months on average to prepare their IPOs, compared to nine months for SMEs that listed on the BSE’s main market. Moreover, listing times were longer in more recent years: ranging 10-12 months in 2015-16 for surveyed firms on the SME Platform. The listing process for SMEs also seems to take far more time than BSE officials anticipate (three months). Listing times did range considerably among SMEs participating in our survey. The shortest preparation time reported by a firm listed on the SME Platform was six months, but it took a third of surveyed firms at least a year to list. While our findings indicate that the time required to prepare an IPO is not a significant deterrent, one in five unlisted, yet qualifying SMEs said that cutting this time would make them more likely to list.

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xvi Nearly half of surveyed unlisted SMEs on the BSE had previously considered listing, but nearly 60 percent of these firms did not qualify. See also India, Section IV, “How unlisted firms view listing.”

And yet there is relative satisfaction with the requirements for maintaining a listing on the SME platform. Together with the already lower reporting frequency, this highlights that there is limited (if any) scope or merit for further easing the process an SME signs up for to maintain its listing on the BSE SME Platform.<sup>xvii</sup> In fact, only one in five unlisted, yet qualifying SMEs said they would be more likely to go public if the stock exchange further simplified the compliance and internal corporate change requirements associated with being a public company. While the ongoing content requirements for financial disclosure for both boards are the same, the SME Platform already has reporting frequency that is half of what is required for a main board listing—requiring only semi-annual versus quarterly reporting.

#### **Box 5. Streamlining a listing**

A listing on the SME Platform streamlines some of the documentation that would be required for a listing on the BSE's main market. The SME Platform sets the minimum number of shareholders at 50 at time of IPO, compared with 1,000 shareholders on the main board.<sup>xviii</sup> The SME Platform requires prospective firms to demonstrate a track record of distributable profits for a period of at least two out of the immediately preceding three financial years. In contrast, the main board requires prospective listing firms to provide evidence of a profitability track record for each of the most recent three financial years. While firms listing on the SME Platform must meet the same prospectus requirements as those on the main board, the filing process has been simplified. Firms applying to list on the SME Platform can file for in-principle approval of their prospectuses directly with the BSE. Firms on the main board must file for an in-principle approval from the national securities regulator. SME Platform firms also are not subject to a one-month public notice ahead of their initial public offering. The purpose of streamlining these filing requirements was to “save about six months” in the listing process for SMEs that go public via the SME Platform.<sup>55</sup> Despite this aim, our findings show that an SME Platform listing often can take longer (see main text).

In addition to easing listing eligibility requirements, the SME Platform has also streamlined the *process* of ongoing compliance for firms. Whereas companies on the main board must deliver printed copies of annual reports to their shareholders, firms listed on the SME Platform can post their annual reports online. Annual listing fees are also significantly reduced on the SME Platform, starting at only INR1,000, compared to a minimum of INR200,000 for firms listed on the main board.

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xvii See, e.g., Harwood and Konidaris (2015), who recommend that SME boards reduce ongoing reporting frequency (rather than content) as compared with those for the main board. They point out that most stock exchanges do not reduce the content of financial disclosure requirements for listings on SME boards because investors expect and require adequate, clear information about SMEs due to their “inherently riskier nature.”

xviii Reduced minimum shareholder requirements at IPO also serve the purpose of alleviating some of the “loss of control” concerns that SME owners/founders often have. See, e.g., World Federation of Exchanges, “WFE Report on SME Exchanges,” 2016.

SMEs ranked tax incentives alongside simplified listing requirements as a top change that could potentially motivate them to reconsider listing on the BSE. Comprehensive information from other countries' experiences on the impact of tax incentives on listings, overall capital market development, as well as the fiscal impact, is limited. This is an issue area that would benefit from further research. There is some anecdotal evidence that tax incentives may motivate a number of companies to list that would not otherwise, and there is a risk that at least a subset of firms would list for the "wrong" reasons. This could damage the overall credibility of the market and increase the likelihood that the SME platform will be regarded as a lower-quality listing tier, potentially driving away investors.

#### **Outreach more important in attracting firms to the SME Platform**

In contrast to the situation in our study's other focus countries, Indian SMEs do not believe they lack information about the pros and cons of going public. No unlisted, qualifying SME in India that we surveyed told us that this lack of information was a problem. But at the same time, these Indian SMEs are much less sure of the process a listed firm must go through and there is significant uncertainty about the cost of going and staying public.

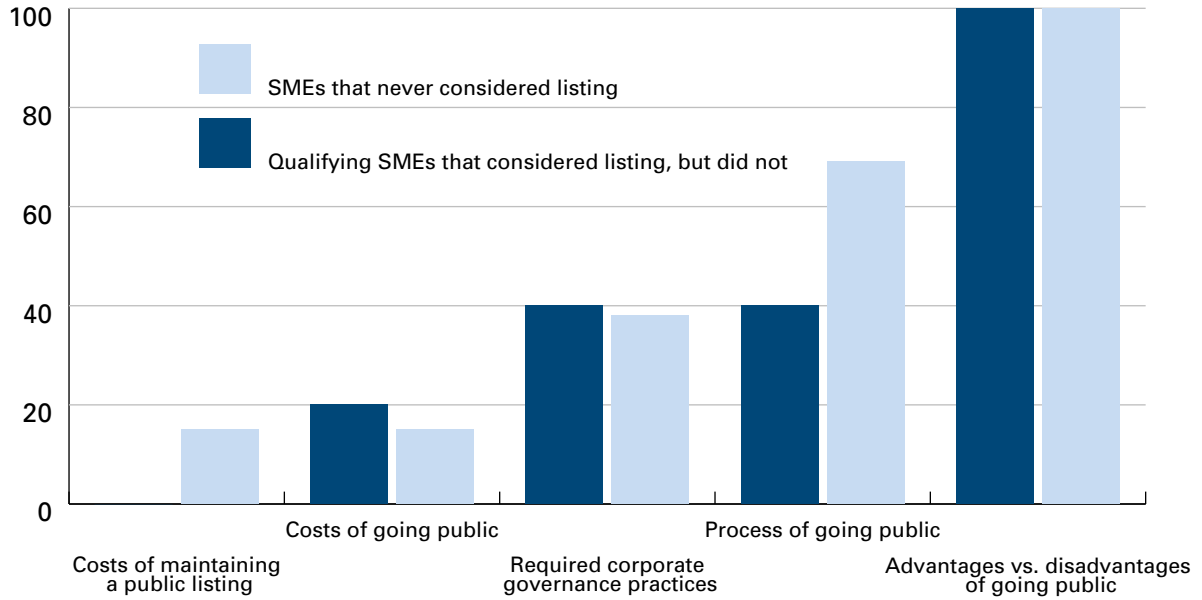
A majority of unlisted qualifying SMEs lack adequate information about the process of going public. And yet a large majority of unlisted SMEs that have never considered listing feel adequately informed about the process. This difference might be explained by confusion occurring once qualifying and interested firms begin exploring the process. Another explanation could be that firms that have decided not to consider the possibility of listing may conclude that they have enough information about the process to stick with this decision. However, a majority of both groups of unlisted SMEs also told us they did not have access to adequate information about the necessary corporate governance changes that would be required to list.

Our survey findings show still more strongly that both groups of unlisted SMEs consider themselves poorly informed about the costs of both getting and staying listed. (See Figure 9.) In fact, all surveyed, qualifying SMEs that had considered a listing indicated that they felt poorly informed about the costs of maintaining a listing and one-fifth indicated they were poorly informed about the costs of getting listed. It's also notable that, among this same group of unlisted firms, the cost of getting listed was the top deterrent, cited by one-third (see also Section IV). At a minimum, this finding suggests that when unlisted firms decide the costs of listing outweigh the benefits, they may be basing their determination on incomplete information.

This set of responses taken together suggests that an increased emphasis by the BSE and other stakeholders on clearly communicating listing costs and requirements may provide more unlisted SMEs with the information they need to make a more informed decision. The survey findings also suggest that the importance of governance and transparency may be useful topics for the stock exchange and other stakeholders to emphasize in future awareness campaigns targeting unlisted SMEs—whether designed by the stock exchange, industry associations, or other parties. Moreover, outreach by the stock exchange and other stakeholders could aim to more concretely make the link between the immediate costs of reforming financial reporting practices and governance structures and the long-term benefits experienced by listed firms in terms of overall operational performance and profitability.

**Figure 9. How well informed are unlisted firms about going public?**

Percent of surveyed firms that have sufficient information on certain aspects of listing



Source: Milken Institute CFM survey of SMEs in India

Currently available outreach to prospective firms seems to have a more important role in attracting listings to the SME Platform than the main market. Two-thirds of listed firms on the SME Platform reported that they had been contacted about the benefits of listing prior to preparing the IPO, while a majority of SMEs on the main board had not been targeted by any outreach efforts.

Notably, SME Platform listed firms reported that SME or trade industry associations were the most common source of outreach ahead of listing (eight of 13 participants). For SMEs listed on the main board, the capital markets authority was the most common source of pre-listing outreach (three of five firms).

The BSE itself funds and carries out education and awareness programs to inform SMEs of the benefits of listing. To do this, it has partnered with trade and industry groups, SME associations, and government agencies at the local, regional, and national level. The exchange believes these outreach efforts have been a major contributor to its early success in attracting listings.<sup>56</sup>

However, no SME Platform firms reported that the BSE had reached out directly in advance of listing to explain its benefits. Just under one in four participating main board listed SMEs had been contacted by the stock exchange ahead of listing about its benefits. Since listed SMEs find authorized intermediaries so useful in assisting with listing compliance, disclosure and corporate governance requirements (see above), stock exchanges might consider enlisting these intermediaries in their outreach efforts to explain to qualifying unlisted SMEs the pros and cons of listing—and the process of going public.

The exchange also offers direct technical and other assistance to firms looking to list—including advising companies on financial reporting and other listing requirements, as well as on navigating the IPO process itself.<sup>57</sup> Roughly a third of listed firms on both boards did not access any direct assistance from the exchange prior to listing, however. Among survey participants, the majority of listed firms received assistance from the exchange in understanding financial disclosure and corporate governance requirements prior to listing (see Table 1).

More firms listed on the main board accessed both of these kinds of assistance than those on the SME Platform. This difference could be explained by the main board requiring more documentation and offering less streamlined processed than the SME Platform. However, unlisted SMEs’ overall lack of awareness about the requirements, process, and costs of going public indicates that more targeted technical assistance and advisory services directed to SMEs considering a listing on either board could better equip more firms with the information and resources to help them list.

Those SMEs that took up assistance with financial disclosure requirements rated it highly, with the vast majority rating it very useful. Firms were more ambivalent about the assistance they received with corporate governance requirements, with only half rating it very useful. Just two firms—one on the main board and one on the SME Platform—availed themselves of the exchange’s help with marketing and public relations and both firms rated this assistance useful. A single firm took advantage of training in investor relations, which it considered very useful.

**Table 1. SMEs accessing available pre-listing technical assistance from the BSE**  
Percent of surveyed firms indicating they received this assistance prior to listing

	Main Board	SME Platform	All Listed Firms
Assistance in understanding financial disclosure requirements	64%	50%	58%
Assistance in understanding corporate governance requirements	57%	50%	54%
The exchange did not directly provide this kind of assistance to my firm	29%	33%	31%
Training in marketing and public relations	7%	8%	8%
Training in investor relations	0%	8%	4%

Source: Milken Institute CFM survey of SMEs in India

Note: Numbers may sum to greater than 100 percent, as some firms relied on more than one type of technical assistance.

### **Box 6. How do authorized intermediaries work with SMEs that list?**

The BSE SME Platform, like many SME exchanges, makes use of authorized intermediaries to assist firms going public. For the BSE, authorized intermediaries may include brokers, financial advisors, law firms, consulting firms, and merchant banks. Among the three focus countries of our study, the BSE's authorized intermediaries in India have the broadest remit. Authorized intermediaries' potential activities include advisory work (such as ensuring compliance with listing, disclosure, and governance requirements and the preparation of IPO documents). They may also serve as underwriters, market makers, auditors, and producers of research and analysis.

The BSE SME Platform has incentives in place that are designed to encourage authorized intermediaries to be judicious about which companies they bring to market. Regulated by the Securities and Exchange Board of India, authorized intermediaries are required to keep 1.25 percent of the issue on their books at the time of a firm's IPO. In addition, appointed market makers are required to make continuous markets for the company for three years after the IPO.<sup>58</sup> However, in determining a firm's suitability as a listing candidate, the exchange does not rely solely on the assessments of its authorized intermediaries, but also conducts its own due diligence.

More than two-thirds of all surveyed listed firms—and three-quarters of those firms listed on the SME Platform—reported that they were required to use some form of designated advisor or other authorized intermediary to guide them through the listing process and advise them after listing. Many of the firms that were required to use an authorized intermediary reported using more than one type of firm. Financial advisers were the most popular among firms listed on the SME Platform, followed by law firms and consulting firms.

## **VI. GRADUATING TO THE MAIN BOARD**

*In Section VI, we review the process by which firms on the SME Platform may graduate to the main board. We also ask whether surveyed firms on the SME Platform desire to graduate—and examine why or why not.<sup>xix</sup> We find that although the SME Platform is intended to facilitate graduations, surveyed firms are, for the most part, reluctant to do so—many find the SME Platform adequate to their needs and do not wish to incur the higher costs associated with listing on the main board.*

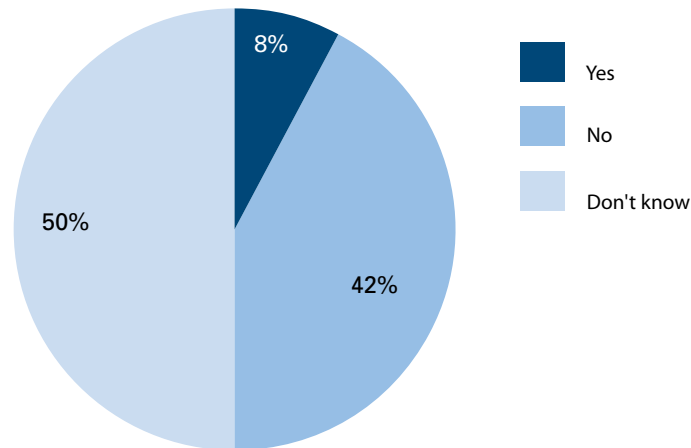
One of the BSE's goals in setting up the SME Platform was to create an on-ramp for new listings on the main board. This is bolstered by rules that require firms to graduate under certain circumstances. According to Indian securities regulations, firms that list on SME exchanges in India, including on the BSE SME Platform, are required to graduate once they meet certain criteria.<sup>xx</sup> This requirement is unusual among SME exchanges internationally, but it is not unique—firms listed on the Jamaica Stock Exchange's Junior Market must abide by a similar requirement. Notably (and unlike in Jamaica), the graduation process is not automatic: firms on the BSE SME Platform will only be compelled to graduate if they take certain actions first. (See Box 7 below.)

xix Our survey sample did not include any main board firms that had graduated from the SME Board, so this section focuses on firms listed on the SME Platform.

xx In India, securities regulators, exchanges, and issuers tend to use the term "migration" in lieu of "graduation."

In theory, firms listed on an SME exchange may wish to graduate in order to access a larger set of investors, to increase their share liquidity, or to enhance their status, among other reasons.<sup>59</sup> However, surveyed firms on the SME Platform were, for the most part, reluctant to graduate onto the main board. Most either did not intend to graduate or were ambivalent about doing so (see Figure 10). Just one surveyed firm planned to graduate to the main board in the next two years.

**Figure 10. India: Do SME Platform firms intend to graduate in the next two years?**  
Percent of firms listed



Source: Milken Institute CFM survey of SMEs in India

The one surveyed firm that does plan to graduate cited several motivating factors, including access to a broader investor base, access to cheaper equity financing, the desire to be seen as a mature firm with a more visible corporate profile, and, finally, greater share liquidity. This firm originally listed on the SME Board to pursue a broader investor base, as well as to reduce its leverage and enhance its creditworthiness.

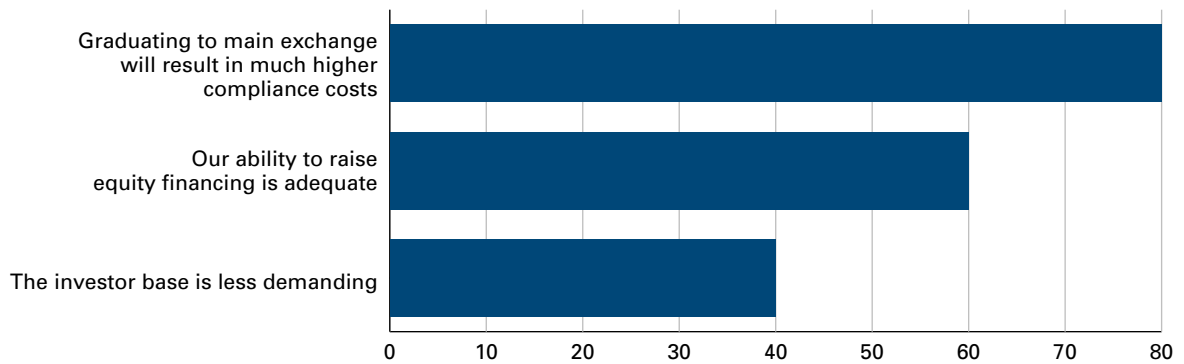
The surveyed firms that do not plan to graduate most commonly cited higher compliance costs as the reason why (see Figure 11). A majority of these firms also indicated that they were satisfied with their current ability to raise funds on the SME Platform. Forty percent said they planned to stay on the SME Platform because the investors there were less demanding than on the main board.

Unsurprisingly, none of the firms that regretted their decision to list on the SME Board said they planned to graduate to the main board in the next two years. Even among firms that would list again, the response was still ambiguous—a majority of these firms said they did not know.



**Figure 11. India: Why some SME Platform firms do not intend to graduate in the next two years**

Percent of firms that do not intend to graduate that cite this reason

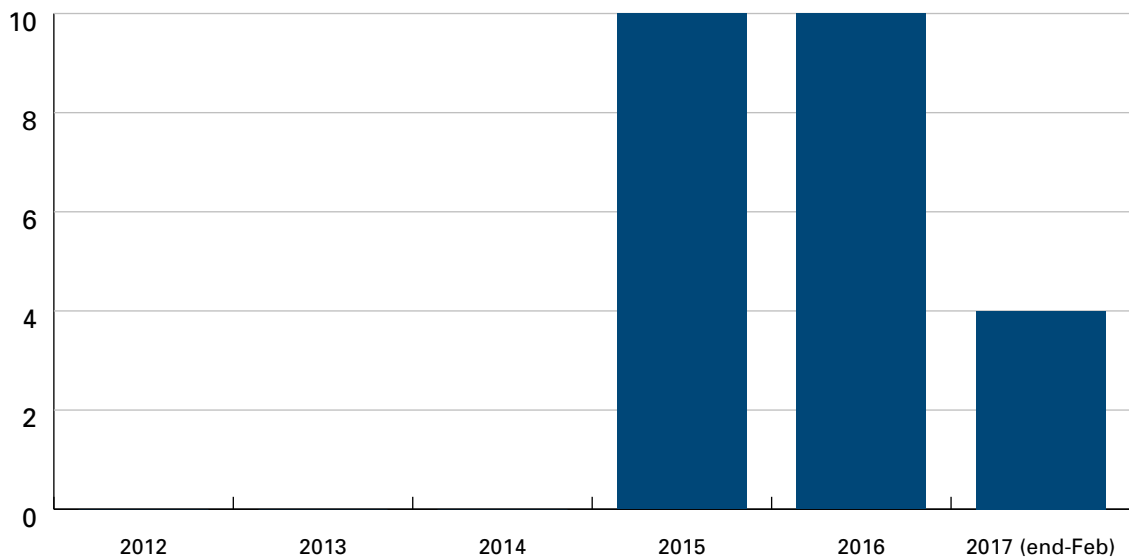


Source: Milken Institute CFM survey of SMEs in India

Despite the findings that firms are reluctant to graduate, it should be noted that the BSE SME Platform has had some success in facilitating graduations. As of early 2017, the BSE SME Platform had facilitated 24 firm graduations, representing about 15 percent of all the firms that have listed since its launch in 2012. The first SME graduated to the main board in February 2015, a little under three years after the SME Platform's launch.<sup>60</sup>

**Figure 12. Annual graduations from the BSE SME Platform to the Main Board**

Number of firms



Source: Milken Institute CFM calculations based on BSE SME Platform company-related notices

Our findings suggest that, where most firms listed on an SME exchange are reluctant to graduate and that SME exchange aims to serve as an incubator for the main board, the SME exchange may need to compel or at least persuade those firms that are ready to graduate to do so. Exchanges should explore whether providing firms with additional technical assistance post-listing would make them more willing to graduate voluntarily. Such assistance might focus on managing investor relations (since some firms expressed concern that investors on the main board would be too demanding) or on cost-efficient compliance (since some firms worried about their ability to handle the additional fees and compliance costs).

**Box 7. Graduation Criteria**

Regulations set out by the Securities and Exchange Board of India (SEBI) in 2010 stipulate that firms are permitted to graduate to the main board once they have been listed on the SME Platform for two years and meet certain financial criteria. Specifically, they must have paid-up capital between INR100m and INR250m (about US\$1.5m to US\$3.7m); and at least 500 shareholders. Firms are required to graduate to the main board if they decide to issue additional shares that will increase their paid-up capital above INR250 million (about US\$3.7m).<sup>61</sup> In both cases, the firm must first obtain approval from two-thirds of its shareholders through a special resolution passed during either an annual general meeting (AGM) or an extraordinary general meeting (EGM).<sup>62</sup> The BSE introduced additional graduation criteria in November 2016, explicitly prohibiting a firm from graduating if its directors, or promoters are debarred by SEBI from accessing India's capital markets.<sup>63</sup>

## SOUTH AFRICA: THE JOHANNESBURG STOCK EXCHANGE'S ALT X

SMEs in South Africa are estimated to contribute about 20 percent of the country's GDP and to employ about 15 percent of its workforce.<sup>64</sup> As in many other developing countries, South African SMEs—especially start-ups—often have difficulty obtaining financing.<sup>65</sup> Lack of access to finance is one of the main reasons South African firms shut down—cited by nearly a third of exiting South African entrepreneurs, compared with an average of just 20 percent for Africa as a whole.<sup>66</sup>

The Johannesburg Stock Exchange (JSE) launched the AltX market segment in 2003 with the intention of expanding access to finance for South African SMEs. The AltX was modeled on the London Stock Exchange's Alternative Investment Market (AIM)—a prominent SME exchange that was founded in 1996 and now lists nearly 1,000 firms. Like the AIM, the AltX is housed under a larger stock exchange and is able to utilize the larger exchange's infrastructure and personnel, thereby taking advantage of economies of scale. Also like the AIM, the AltX makes use of third-party intermediaries to shepherd SMEs through the listing process.

In its first four years of business, the AltX saw a steady stream of listings and in 2007, its market capitalization peaked. But then in 2008, new listings slowed and delistings picked up.<sup>xxi</sup> The total number of firms listed on the AltX has declined from a peak of 76 in 2009.<sup>67</sup> The World Bank has attributed this stagnation to lack of interest from institutional investors and to the "low savings and investment culture in South Africa."<sup>68</sup> At the same time, however, the AltX has nonetheless facilitated a significant number of graduations to the main board—more than 30, as of mid-2016. These firms now represent about 10 percent of all firms listed on the JSE's main board.

At the time of the survey, there were 62 firms listed on the AltX. Although the AltX does not target any particular sector, the industry composition of the AltX is heavily tilted toward the financial sector—84 percent of firms listed on the AltX are financial firms. JSE managers observe that in recent years, firms listing on the AltX are more "corporatized" than in the past, and are less likely to be family-owned. The AltX merits study as one of the longer-standing emerging-market SME exchanges—one that has experienced both successes and difficulties, and has persisted through a variety of economic circumstances.

### I. THE DECISION TO LIST

*In Section I, we compare the listing motives of surveyed South African SMEs on the Johannesburg Stock Exchange's main and SME boards. We also compare the main reasons SMEs told us they opt for a listing with the JSE's perceptions of these listing motives and the exchange's aims for setting up and operating the SME board. We find that enhancing financial access is a less important motive for SMEs listing on the JSE than for SMEs in our study's other focus countries, India and Jamaica.*

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xxi According to JSE officials, nearly all delistings on the AltX have resulted from acquisitions, as opposed to regulatory non-compliance or liquidation.

We found that South African SMEs are more strongly motivated to list for reasons independent of financial access, especially on the SME board, AltX. Firms listing on both boards had the same top reason for listing—positioning themselves for growth. But firms on the SME platform were more strongly motivated by this aim. The motive of raising market visibility to improve firm or brand reputation has been an important driver of SME listings on both boards. (See Figure 13.)

One explanation for the overall preference of the SME board over the main board for reasons not directly related to financial access is that many of these firms may be at earlier growth phases of their business life cycles. Notably, a majority of new listings on the AltX over the past five years were firm seeking exit for early-stage investors (such as venture capital and/or private equity) at time of listing.<sup>69</sup> Moreover, SMEs on the main board may be in a more established phase of their business life cycles with more focus on maintaining brand reputation in a competitive marketplace. This holds broadly across the sample, with the two youngest participating firms listed on AltX. Although the oldest participating firm is also an AltX listing, the next three oldest participating firms are all main board firms.

Diversifying the investor base also has been a top reason SMEs list on the JSE. Somewhat surprisingly, this motive was stronger for surveyed firms on the SME board compared with the main board. Our findings show that the stock exchange may be underestimating the importance firms place on diversifying the investor base as a major driver attracting them to list on AltX.

There is a perception that firms listing on AltX historically have not shown that much interest in broadening their investor bases. And the common observed pattern in capital markets typically has been one where companies take more interest in diversifying their investor base as they grow and mature in their listing cycle, particularly those that migrate to the main board. A recent stocktaking of practices and experiences across several SME exchanges noted that a main motive of graduation to the main board is to gain access to that board's larger investor base and greater institutional investor appetite in particular, and associated increased liquidity.<sup>70</sup> The apparent incongruity of this typical pattern and preference with our survey findings could be partly due to changes in characteristics of firms listing on AltX in the past several years—whereby family-owned firms make up a smaller share of new listings.<sup>71</sup> Our findings also show that, among our three focus country stock exchanges, the JSE had the smallest percentage of family-owned firms among total new listings on the SME board over the past five years.

Nevertheless, this listing aim may have left a number of firms on the AltX unsatisfied, with close to half of participating firms finding their ability to attract more diversified investment falling below expectations. (See also Section III below.) Institutional investors continue to prefer the main board. Although it is a sizeable SME exchange, AltX continues to face challenges in generating sufficient liquidity. That said, the overall liquidity ratio for AltX increased from 6.8% in 2013 to 10.16% in 2015, reflecting increased trading activity—although still much smaller than 43 percent on the main board.<sup>72</sup>

**Figure 13. Main reasons South African SMEs list**

Percent of surveyed firms that include each factor as a top motivation



Source: Milken Institute CFM survey of SMEs in South Africa

While our findings show that enhancing financial access is not a top reason why SMEs list on either board, it's a stronger driver for SME board than main board firms. Just under half of participating firms on the SME board cited improving the ability to raise additional finance including from banks as a motive. No participating SMEs—on either SME or main boards—specifically mentioned improving creditworthiness as a main motive for listing. The prospect of raising capital at a lower cost is a somewhat more important driver for main board firms, however, with a minority of surveyed SMEs on both boards mentioning this.

SMEs' top listing motives seem to be largely in synch overall with two of the JSE's primary aims for setting up and operating AltX: helping firms grow and increasing SMEs' access to medium- to long-term financing. The exchange correctly sees positioning firms for growth and raising capital as important reasons why SMEs seek an AltX listing. The JSE may be overestimating the relative importance SMEs place on listing as a vehicle for directly increasing access to medium- to long-term finance.

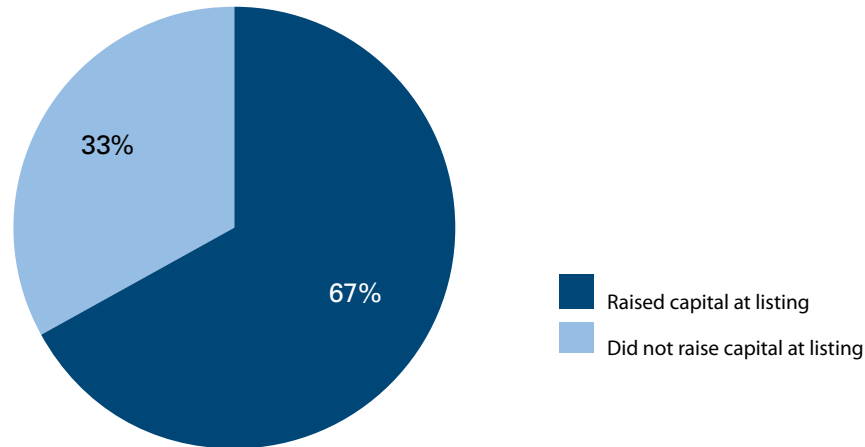
Only one surveyed SME (a mainboard firm) pointed to the opportunity to improve financial reporting and transparency standards as one of its most important reasons for listing. Perhaps this listing benefit is only directly apparent to firms with much hindsight: this firm was the longest-listed firm of our sample. In contrast, the JSE considers improving financial reporting and transparency standards to be an important consideration in motivating firms to list. Through well-targeted awareness raising outreach with current and prospective listed firms, the JSE and other capital markets stakeholders may be able to change SME perceptions about the expected effects of meeting financial reporting and transparency standards. (See also Section V.)

## II. LISTED SMES AND ACCESS TO FINANCE

*In Section II, we first ask whether firms raised capital upon listing. For those that did, we then look at how they used their IPO proceeds. We found that two-thirds of surveyed firms raised capital upon listing and that AltX firms directed their IPO proceeds toward a wider variety of funding needs than did firms on the main board. Next, we look at how firms accessed other sources of medium- to long-term finance after listing. We also found that subsequent to listing, a majority of surveyed firms on the main board raised additional finance, but that only a minority of AltX firms did so.*

Two-thirds of surveyed firms raised capital upon listing (see Figure 14). This includes 60 percent of main board firms and 70 percent of AltX firms. Most of the firms on both boards listed through an initial public offering. Two firms, both on AltX, listed through other avenues: one via a private placement and the other via a reverse listing. Among AltX firms that raised capital upon listing, the amounts ranged from ZAR7m (about \$852,600) for a firm that listed in 2012 to ZAR60m (about \$5.5m) for a firm that listed in 2014. Only two surveyed main board firms reported how much capital they raised: one firm raised ZAR28m when it listed in 1999 (about \$4.5m) and the other raised ZAR285m in 1995 (or about \$78.5m).<sup>73</sup>

**Figure 14. Did firms raise capital at the time of listing?**  
Percent of all surveyed listed firms

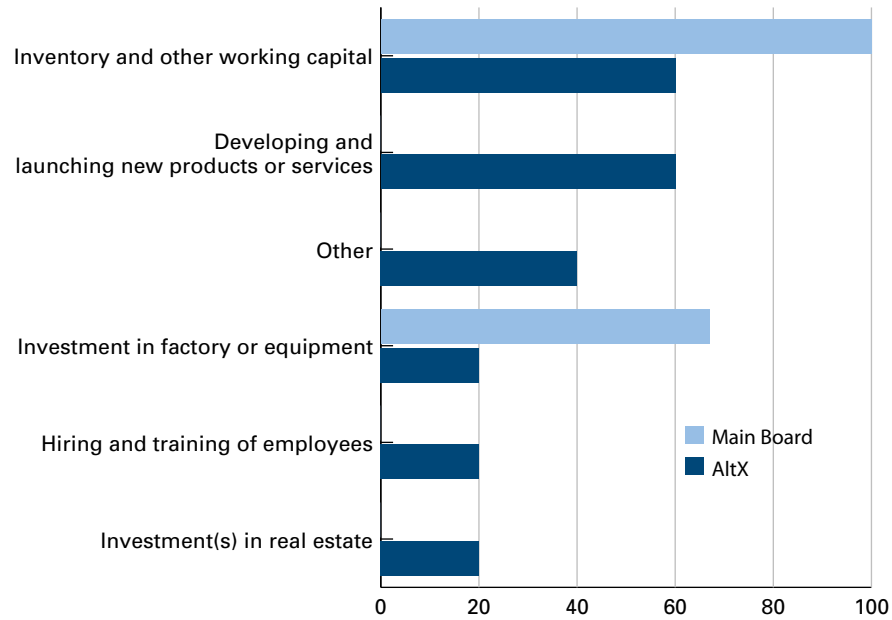


Source: Milken Institute CFM survey of SMEs in South Africa

Firms on both boards directed their IPO proceeds toward both short- and long-term uses. However, firms that listed on the AltX tended to direct their proceeds toward a wider variety of funding needs than did firms that listed on the main board (see Figure 15). Surveyed AltX firms frequently came from innovative and dynamic sectors, including financial services and technology, so it is no surprise that these firms often used some of their proceeds to invest in new product development. A few firms that listed on the AltX used their proceeds for other reasons, including hiring and training employees, making investments in real estate, and financing an acquisition. One financial firm reported using the proceeds for private equity investments. None of the surveyed AltX firms were manufacturers, which may explain why they were less likely than main-board firms to use IPO proceeds for either working capital or factory and equipment.

**Figure 15. Use of IPO proceeds by listing venue**

Percent of firms that used some IPO proceeds to fund this expenditure



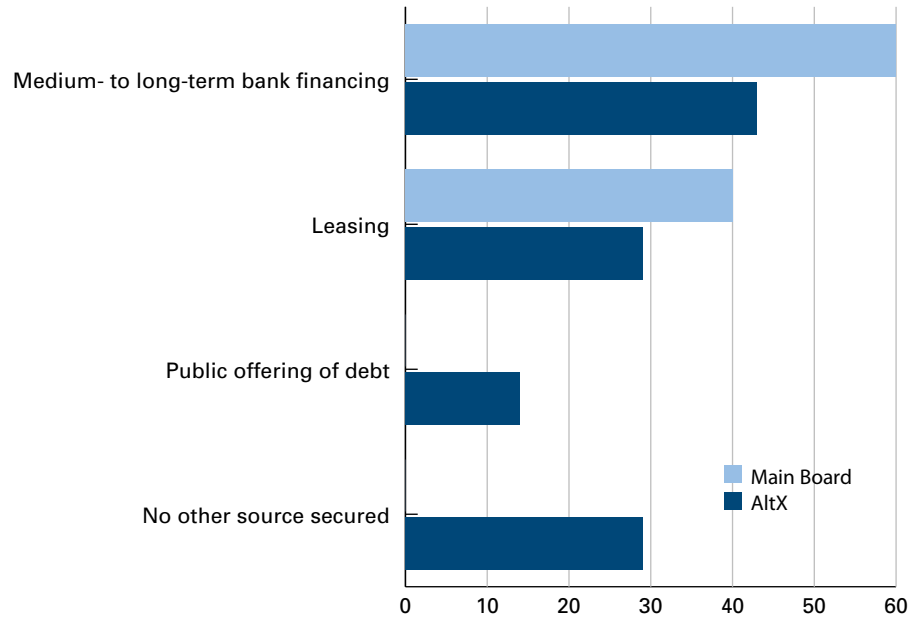
Source: Milken Institute CFM survey of SMEs in South Africa

In contrast to AltX firms, firms that listed on the main board reported using their IPO proceeds for just two purposes: investments in factory and equipment, and financing inventory and other working capital needs. All responding main board firms used at least some of their IPO proceeds for inventory and other working capital needs, though just one firm used its IPO proceeds exclusively for this purpose. Two-thirds of responding main board firms used some of their IPO proceeds to invest in factory and equipment. These funding priorities may reflect the fact that the surveyed firms that listed on the main board hailed from industries such as manufacturing, construction, and basic materials, which often require substantial investments in fixed assets and also have significant working-capital needs.

Firms listed on the AltX were less likely than SMEs on the main board to report that they had accessed additional post-IPO finance (see Figure 16). Unlike firms that listed on the main board, only a minority of firms that listed on the AltX reported accessing some form of additional post-IPO finance. Moreover, two of the surveyed AltX firms confirmed that they had not secured any additional finance since becoming public companies.

For firms on both boards, banks were the most common source of additional medium- to long-term financing, followed by financial leasing. One firm, which initially listed on the AltX but has since graduated to the main board, reported that it had raised capital through a public debt offering. Three firms have made secondary issuances—all of which initially listed on AltX, including the one that subsequently graduated.

**Figure 16. Accessing medium- to long-term finance after going public**  
Percent of firms that raised this type of financing post-IPO



Source: Milken Institute CFM survey of SMEs in South Africa

### III. ASSESSING THE LISTING EXPERIENCE

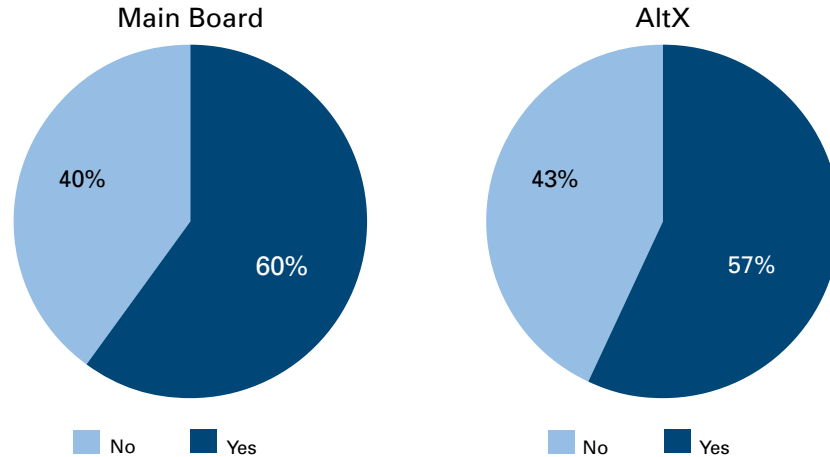
*In Section III, we look at whether, based on their experience, firms would make the same decision to list if they had to do it all over again. This section also details the aspects of listing that have met with or exceeded firms' expectations before turning to the causes of discontent. While slight majorities of firms that listed on both boards would repeat the process, over 40 percent of listed SMEs regretted their original listing. Across many factors, the experience of listing was in line with what firms expected, but those areas where listing fell below expectations reveal interesting differences between the main board and the AltX.*

SMEs in South Africa registered the highest rate of dissatisfaction about their original listing decision out of the three countries in this study. Only a small majority of surveyed SMEs on both boards were satisfied with their listing decision. These firms—on both the main market and the AltX—identified the ability to grow their business as well as enhanced access to capital as reasons they remained happy with their listing decision. One SME on the main board also noted increased exposure and brand recognition as a key benefit and one firm on the AltX was pleased with listing on the exchange because it provided early-stage investors with an exit opportunity.



**Figure 17. Would SMEs choose to list again?**

Percent of surveyed listed SMEs



Source: Milken Institute CFM survey of SMEs in South Africa

While majorities of SMEs on both boards found that being listed met their expectations for a number of factors, very few firms noted that the listing had exceeded expectations—far fewer than in India or Jamaica. (See Figure 18 below.) Across multiple indicators, never more than 20 percent of South African SMEs reported that listing had exceeded the expectations they held when they originally went public. The same does not hold true when we examine which aspects of listing turned out to be worse than firms were expecting. Large percentages of firms on both boards found that being listed failed to live up to expectations in several ways. These areas reveal interesting differences between the experiences of firms on the AltX versus the main board.

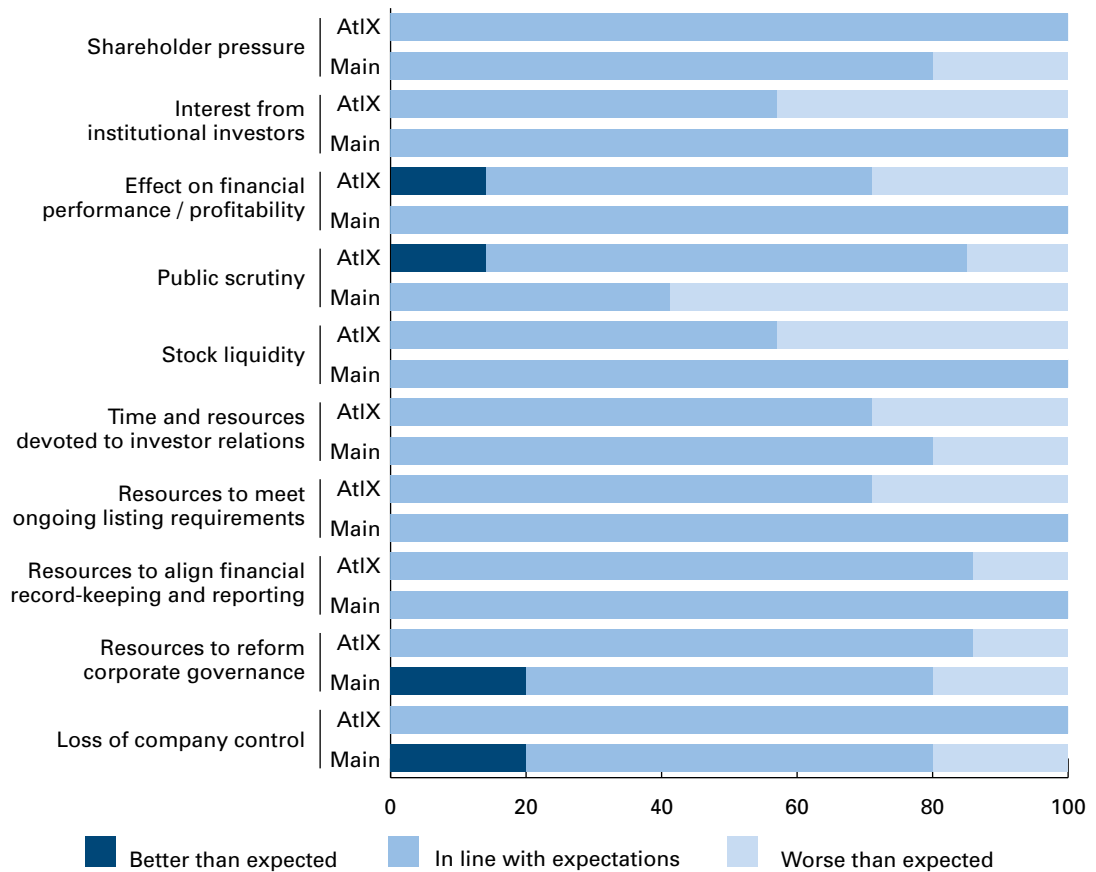
Those firms that listed on the main board that would not list again—as well as the one firm that had graduated to the main board from the AltX—all cited the costs of being listed as the main reason behind their current dissatisfaction. One surveyed company on the main board explained that “[a]s a small cap firm, listing is expensive for the value we gain.” None of the firms on the AltX that regretted their listing, however, cited the costs of being listed explicitly. Instead, they noted that the promised benefits of listing did not pan out in their experience; these firms were originally looking to enhance their branding and reputation and to increase their competitive advantage.

Additional survey evidence, however, suggests that the cost of listing and maintain a listing can weigh as heavily on AltX firms as their peers on the main board. Across three key indicators related to resources required to list and maintain a listing, SMEs on the AltX reported higher rates of unmet expectations than their peers on the main board. About 30 percent of firms on the AltX said that the time and costs of meeting ongoing listing requirements had turned out to be worse than anticipated. No firms on the main board said the same. Likewise, 29 percent of SMEs on the AltX were disappointed by the resources they had to devote to investor relations, compared to 20 percent of firms on the main board. And while 14 percent of surveyed AltX firms found the time and costs of aligning financial recordkeeping with listing requirements to be more burdensome than anticipated, 100 percent of participating SMEs on the main board said their experience in this regard was in line with expectations. In terms of the time and costs of reforming governance structures to list, the overall experience of surveyed firms on the main board and SME board was comparable. Unlike in India, for example, content requirements and frequency are the same on board, and this fact likely contributes to these results.

Nearly half of AltX-listed firms said the experience of being listed was worse than expected for two related reasons—insufficient liquidity and institutional investor interest. By comparison, all five firms listed on the main board reported that liquidity levels and institutional investor interest were in line with expectations. These findings are perhaps unsurprising as low market activity is a known challenge facing the AltX. As Harwood and Konidaris (2015) note, small ticket size and illiquidity prevent many institutional investors from participating in AltX.<sup>74</sup> According to data from the exchange management, the annual turnover ratio for the AltX in the year prior to the survey (2015) was 10 percent, compared to a turnover ratio of 43 percent on the main board. In India, by comparison, the SME Platform actually had a higher turnover ratio than the BSE’s main market.

Negative public scrutiny was much more of an issue for main board than AltX-listed SMEs. A majority—60 percent—of participating SMEs on the main board reported that public scrutiny as a listed company had been harsher than they had expected when they first joined the JSE. Only 14 percent of surveyed firms on the AltX had the same negative experience. In a related finding, 20 percent of firms on the main board found shareholder pressure to be worse than anticipated, while all surveyed firms on the AltX had this aspect of listing to be in line with expectations. Taken together, these findings suggest that SMEs on the main board find themselves more exposed to pressure from stakeholders, and it is possible that choosing to list on the AltX may insulate firms from what is perceived as negative attention. This implication, though, likely merits further study.

**Figure 18. Experience versus expectation for listed South African SMEs**  
Key indicators compared across the AltX and the main board



Source: Milken Institute CFM survey of SMEs in South Africa

#### IV. HOW UNLISTED FIRMS VIEW LISTING

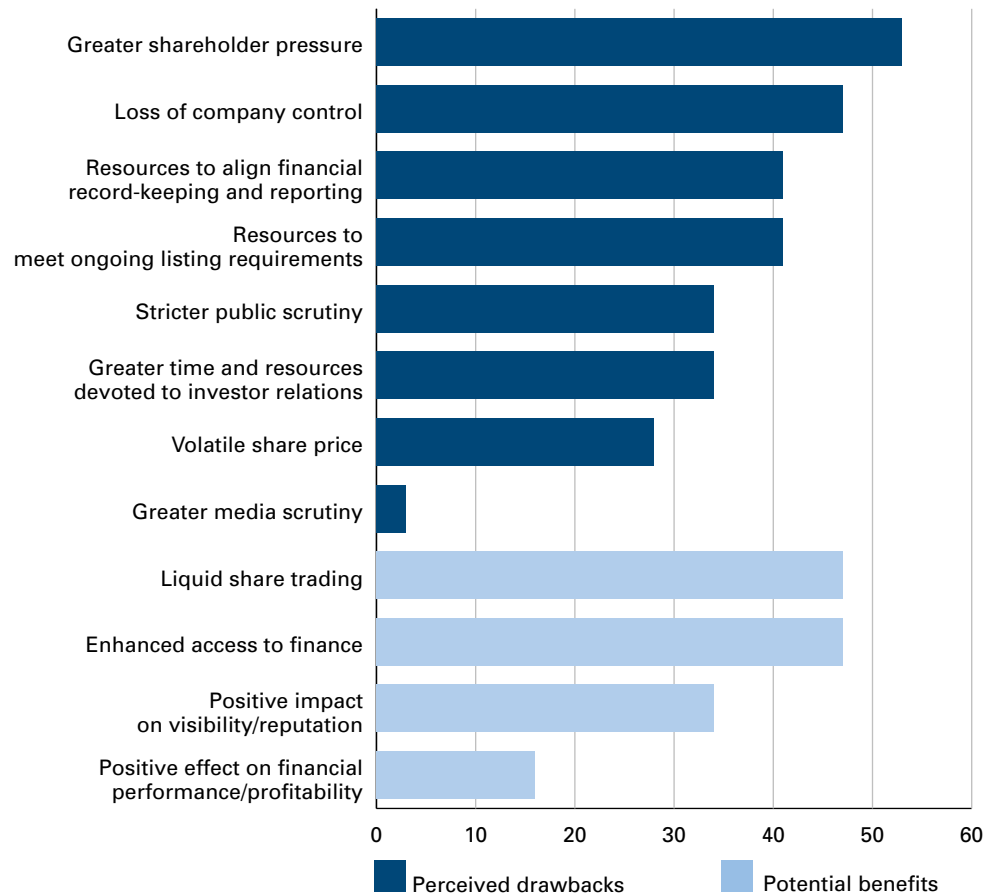
*In Section IV, we review the associations unlisted firms have about becoming a public company. We also look at why firms that met listing requirements and considered a listing ultimately decided not to list and at whether or not firms would consider a future listing. In South Africa, perceptions of unlisted SMEs are more balanced between perceived advantages and drawbacks of a listing, in contrast to the predominately negative associations held by unlisted firms in India.*

The strongest association with being listed on a stock exchange for unlisted South African firms was greater shareholder pressure, as cited by 53 percent of surveyed SMEs. Nearly half of firms also connected a public listing to loss of company control. Interestingly, though, just under 50 percent of surveyed unlisted firms also cited the positive benefits of liquid share trading and enhanced access to finance as perceived outcomes of issuing public stock. At the time of the survey, the exchange management appeared to be well aware of the negative associations unlisted firms would have with going public, but generally unaware of these positive associations.

The fact that two of the strongest associations were positive offers an interesting contrast to unlisted firms in India—and a possible opportunity for the exchange to capitalize on in its outreach to prospective firms. As in India, though, it appears that unlisted South African SMEs may form their views of going public more around the reputation of JSE's main board rather than that of the younger AltX. As noted above in Section III, shareholder pressure was more likely to be a concern for companies on the JSE's main board, while the advantage of liquid share trading was also more likely to be an outcome of listing on the main board, compared to the AltX. The fact that unlisted firms connect going public with these outcomes suggests they may have the main board in mind. Emphasizing the experience of firms on the AltX, where these issues seem to be less of a factor, could improve the view of going public among South African SMEs overall.

**Figure 19. What unlisted South African SMEs associate with a listing on a stock exchange**

Percent of firms that hold this association



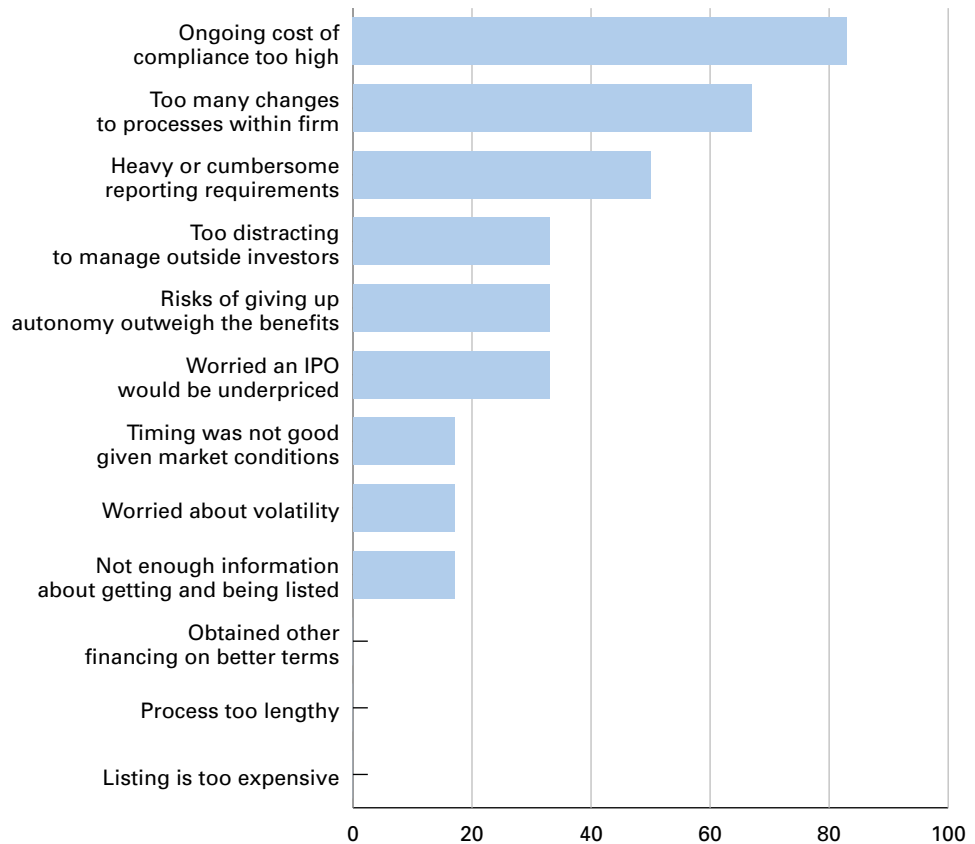
Source: Milken Institute CFM survey of SMEs in South Africa

Only 16 percent of unlisted firms associate being listed with the positive outcome of improved financial performance and profitability. This perception mirrors the experience of SMEs that list on the AltX, nearly 30 percent of which reported that listing failed to deliver anticipated benefits to their firms’ financial performance.

Among unlisted firms, 63 percent had previously considered a public listing. Of this group, more than two-thirds discovered that they did not meet the listing requirements. The others eventually decided not to go forward with a listing. Their reasons for this decision are notable as they reveal that unlisted firms are more concerned about the costs of maintaining a listing more than the upfront resources required to get listed.

Over 80 percent of SMEs that could have listed but decided not to determined that the ongoing cost of compliance was too high, and 67 percent decided that the listing requirements entailed changing too many processes within their firm. Half of the group were concerned about heavy or cumbersome reporting requirements. These concerns about the resources required to maintain a listing would, in most cases, not be alleviated by listing on the AltX compared to the main board. While it is true that firms listed on the AltX pay a cheaper, flat annual listing fee compared to firms on the main board, the content requirements and frequency of disclosure are the same on both boards. Interestingly, no firm that met the listing requirements, but decided not to list based their decision the initial costs of listing or the length of the listing process. And no firms reported deciding not to list because they were able to find more attractive financing options.

**Figure 20. Why qualified SMEs decided not to list**  
 Percentage of firms that met listing requirements, but chose not list



Source: Milken Institute CFM survey of SMEs in South Africa

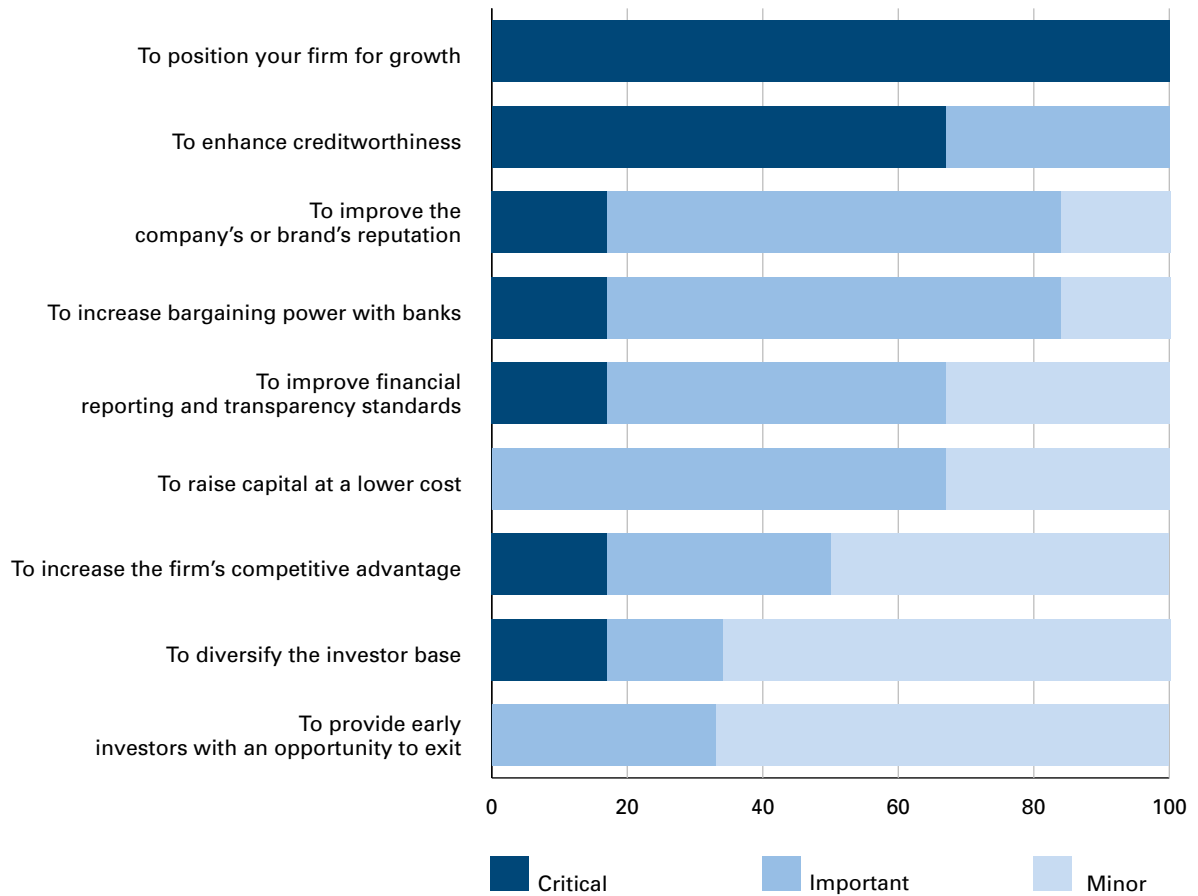
Those companies that had never previously considered a listing—38 percent of the sample of unlisted SMEs—most frequently identified cumbersome reporting requirements as the factor that ruled out going public for their firm. Half of this group of unlisted firms cited this reason. Others noted that the owners were simply not interested in the idea, and a quarter of firms explicitly pointed to the potential loss of company control as determinative for why they had not looked into issuing stock.

Asked whether listing might one day be an option for their company, 72 percent of South African SMEs said they did not know one way or another. About 20 percent, though, would consider a future listing. Only 9 percent were entirely convinced that they would never list.

South African SMEs that were open to going public in the future signaled that their decision would depend on several core financial and non-financial motivations. All firms in this group said that being able to position their company for growth would be critical to their decision. Enhancing creditworthiness and the related goal of gaining a stronger bargaining position with lenders also ranked highly among the factors firms would consider. This group of South African firms also appeared to understand the potential benefits of putting their books in order to list, with two-thirds pointing to improving financial reporting standards and transparency as critical or important to how they would decide on a future listing.

The least important motivations for these companies as they thought about possibly going public were diversification of their investor base and providing early-stage investors an exit opportunity. The latter finding is somewhat surprising in the context of the large number of private equity exits via listing on the AltX. According to exchange officials, 55 percent of firms that list on the AltX do so as part of a private equity exit.

**Figure 21. What are the most important motives that could drive a future listing?**  
Percentage of unlisted firms ranking importance of each motive



Source: Milken Institute CFM survey of SMEs in South Africa

Overall, slightly more than half of unlisted SMEs said they would be more likely to list if the stock exchange further simplified listing procedures. About the same number—44 percent—believed lowering listing thresholds would make listing more likely. Half of unlisted South African SMEs said that offering tax incentives to listed firms would increase their likelihood of listing. The AltX management team also believed that tax incentives could increase listings, but these introducing incentives should be approached cautiously. As Jamaica’s experience shows, tax breaks for listed firms can lead to new listings, but it will likely cause headaches for policymakers later on.

## V. MAKING LISTING MORE ATTRACTIVE

*In Section V, we examine the changes that unlisted, yet qualifying SMEs themselves indicated in our survey would make it easier to and more likely they would take their firms public. Unlisted South African SMEs that qualified but decided against listing generally were clear on the costs and procedures of a new listing, but were much less certain about the ongoing listing costs. We also discuss our findings on the kinds of advisory and other assistance available to SMEs planning to list—and how useful they find it.*

SMEs must meet the same disclosure and other requirements for listing on the SME board in South Africa as for a main board listing. Authorized intermediaries, however, provide considerable support in guiding SMEs through the listing process and remain with firms throughout their time listed on the JSE (see below). In spite of this additional guidance and the generally quicker process to an IPO on AltX, a large majority of eligible, unlisted SMEs<sup>xxii</sup> said more simplified listing procedures would encourage them to reconsider a listing. As many as two-thirds of these surveyed firms said it was one of the two top changes that prompt them to reconsider a listing decision. This may be partly in response to the JSE’s tightening of listing requirements and processes in recent years including to deter reverse listings.

Unlisted SMEs, even when deemed eligible to go public, show significant resistance to the internal changes required. The changes SMEs need to make to internal processes may be the most difficult part of the listing process, regardless of whether other documentation requirements are streamlined or waived. Two-thirds of eligible firms said they decided not to list because of these changes. (See also Section IV.) At the same time, none of these surveyed firms said that technical assistance (TA) or capacity building to help prepare a listing would encourage them to seek a listing. That said, there may be scope for attracting some good listing candidates to AltX by reducing reporting *frequency* (rather than content) as compared with frequency requirements for the main board.<sup>xxiii</sup>

As many as two-thirds of participating listing-eligible firms said tax incentives would prompt them to consider taking their firm public. Comprehensive information from other countries’ experiences on the impact of tax incentives on listings, overall capital market development, as well as the fiscal impact, is limited. This is an issue area that would benefit from further research. (See also Section V of the India chapter on page 31.)

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xxii Nearly two-thirds of surveyed unlisted SMEs on the JSE had previously considered listing, but nearly 70 percent of these firms did not qualify. See also Section IV, “How unlisted firms view listing.”

xxiii See, e.g., Harwood and Konidaris (2015), who point out that most stock exchanges do not reduce the content of financial disclosure requirements for listings on SME boards because investors expect and require adequate, clear information about SMEs due to their “inherently riskier nature.” Unlike many SME exchanges, disclosure frequency for the AltX is the same as that for the main board.

Our findings show that none of the surveyed SMEs that are eligible to list (but have not) find the time required a deterrent. The process of listing on the AltX is generally quicker on average than on the main board for surveyed SMEs. The average length of time ahead to list was 7.25 months for participating main board firms compared with five months for SME board firms. Listing times for surveyed firms on the SME board in more recent years were considerably shorter (at three to four months) compared with several years ago (six months).

Our findings indicate that unlisted, qualifying South African SMEs that had previously considered listing believe they have adequate information on the process involved in going public and the associated pros and cons. Some of them are less certain of the costs of getting listed—with nearly 20 percent of them saying they don't have enough information. Still, a sizeable majority of these firms believe they have the information needed to list, if they choose to do so (see Figure 22). This may reflect that there is structured advisory support and guidance on what firms must do to list, which is mandatory for SMEs seeking to list in this market, provided through the Directors' Induction Program as well as mandatory authorized intermediaries (see Boxes 8 and 9 below).

#### **Box 8. Induction of SME directors on going public**

AltX and the Institute of Directors of South Africa (IoDSA) jointly run a Directors' Induction Program (DIP) that company directors of all firms that list on AltX are obliged to attend ahead of listing. IoDSA describes this program as “interactive,” with the aim to equip directors of AltX-candidate firms with the “practical tools” needed to prepare and lead a publicly-listed firm.<sup>75</sup> This compulsory “education program” is intended to bring prospective firms up to speed on listing requirements and related corporate governance and other regulations. Notably, directors of firms listing directly on the main board also are welcome, but not required, to attend the DIP.

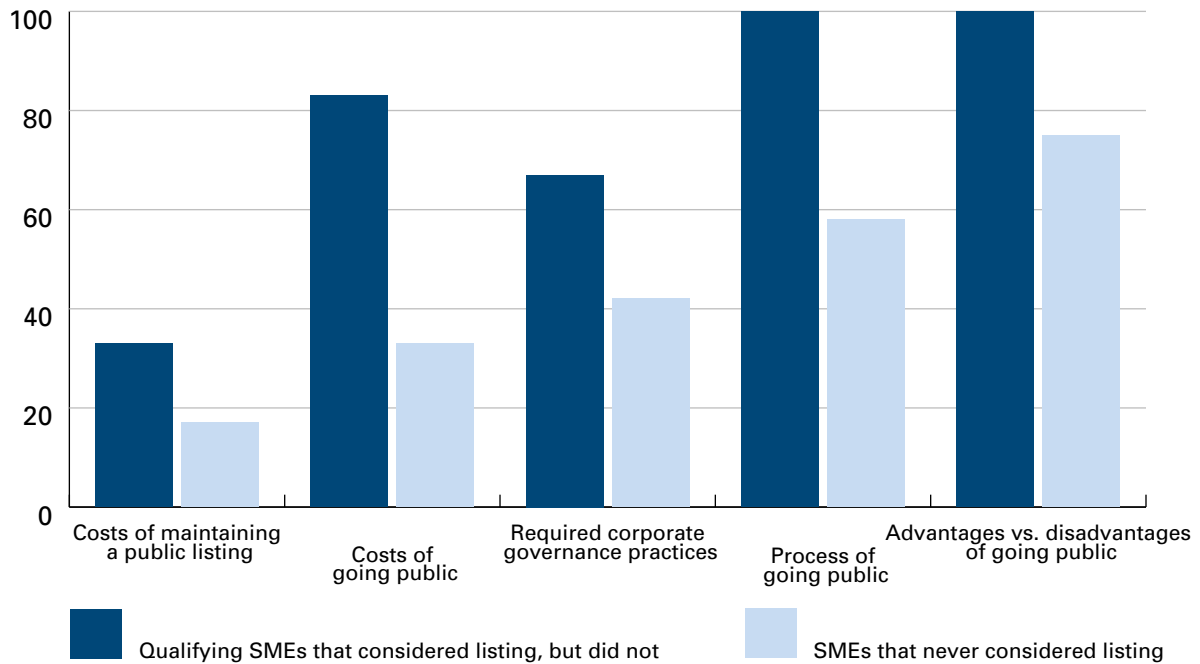
This “induction” is intended to guide and prepare the top management of SMEs that list on AltX in particular, since, significantly, they must lead their firms in ensuring compliance with the same disclosure requirements—in reporting content and frequency—as a firm listed on the JSE's main board. All listed firms, regardless of which JSE platform they choose, are obliged to disclose price sensitive information and produce twice yearly (interim and annual) financial statements.

Around two-thirds of firms that had considered joining the exchange in the past feel uninformed about the costs involved in maintaining a public listing, however. A third are not confident they have adequate information about the mandatory corporate governance requirements. These responses broadly align with the top reasons this group of SMEs has for remaining unlisted: ongoing cost of compliance and internal changes needed to go public. (See also Section IV). However, this combined feedback may indicate that perceived confusion about the ongoing costs of being listed could be as much a deterrent to some firms as the actual ongoing financial and operational costs. This finding certainly flags an opportunity for capital markets stakeholders to aim to bridge this information gap with qualifying yet unlisted firms. At a minimum, increased emphasis on clearly communicating listing costs and requirements to unlisted, qualifying SMEs may provide more of them with the information they need to make a more informed decision.



**Figure 22. How well-informed are unlisted firms about going public?**

Percent of surveyed firms that have sufficient information on certain aspects of listing



Source: Milken Institute CFM survey of SMEs in South Africa

Compared with our other focus country markets, a wider range of organizations in South Africa reportedly carry out education and awareness programs to inform SMEs of the benefits of listing. The JSE AltX provides education and awareness programs to inform SMEs of the benefits of listing including by partnering with sponsors and investment banks, as well as industry associations. Separately, the Financial Services Board, South Africa’s securities regulator, as well as international donors, industry associations, and sponsors and investment banks are engaged in education and awareness programs. Despite these initiatives, however, surveyed South African firms reported participating in less outreach ahead of their decision to list than their counterparts reported in India and Jamaica. Half of listed firms on the SME Board reported that they had been not contacted by any organization about the benefits of listing prior to preparing the IPO. Only one surveyed firm now listed on the SME board reported being contacted by the stock exchange. A large majority of SMEs on the main board could not recall being targeted in advance by any outreach efforts.

Somewhat surprisingly, only half of surveyed SMEs listed on the AltX in the past several years indicated they were aware that any organization had actively reached out to inform them about the benefits of listing in advance of their listing decision. According to these surveyed SMEs, outreach—where it occurred—was primarily provided directly by sponsors, investment banks, or advisors. This finding is somewhat surprising since each SME that decides to list on AltX must undergo a structured, mandatory advisory and preparation process. This includes a requirement, in advance of an actual listing, that an SME must appoint a designated advisor to “guide [it] through the listing process.”<sup>76</sup> Since listed SMEs find authorized intermediaries so useful in assisting with listing compliance, disclosure and corporate governance requirements (see above), the stock exchange might consider enlisting these intermediaries more extensively as partners in early outreach efforts to explain to qualifying, unlisted SMEs how these requirements work for publicly listed firms.

### **Box 9. Authorized intermediaries facilitate listing process for SMEs**

All SMEs are required to work with a designated authorized intermediary to guide them on requirements and procedures for listing on the JSE and as a public company. In contrast to this study's two other focus countries (India and Jamaica), it is mandatory for the intermediary to remain with the listed firm until they delist.

All but one of AltX-listed firms mentioned they accessed help from authorized intermediaries specifically in complying with listing, disclosure and governance requirements. Fewer than half of surveyed main board listed SMEs said they had accessed this assistance. All SMEs that used these services found them beneficial, with half of them describing them as very useful.

Our survey findings show that the most important role of these authorized intermediaries in South Africa is to assist SMEs in preparing IPO documents—mentioned by all participating SMEs on the SME board and nearly all on the main board. All participating SMEs found these services useful, with nearly one-third of SME board firms finding them very useful.

Assistance with investor relations was only mentioned by a minority of surveyed SMEs, but AltX-listed firms were more likely to access this service. Nearly half of participating firms on AltX received assistance with investor relations compared with only one main board firm. All surveyed SME board firms that used this service found it useful to very useful, while the main board firm found it somewhat useful. With diversifying the investor base an important listing motive for firms on the SME board, there is an opportunity for making more SMEs aware of this service as they consider listing.

The exchange also offers a range of direct technical and other assistance to SMEs seeking to list including training in marketing and public relations, as well as advising companies on financial reporting and other listing requirements, investor relations, and navigating the IPO process itself.<sup>77</sup>

Despite the wide range of technical assistance available, nearly half of SMEs listed on both AltX and the main board said they did not access any kind of pre-listing assistance from the exchange prior to listing. The top-cited forms of technical assistance accessed by surveyed firms listed on AltX was for meeting corporate governance and financial disclosure requirements. Two-thirds of the firms that did access this assistance rated it useful to very useful. A similar ratio of main board listed SMEs accessed assistance for understanding corporate governance requirements, but were less likely to access help in understanding financial disclosure requirements. (See Table 2.)

None of the unlisted SMEs that had qualified for but decided against listing said that receiving technical assistance to help prepare a listing would encourage them to reconsider. Nevertheless, better communication about the usefulness of this assistance to listed SMEs that had accessed it could help capital markets stakeholders encourage at least some of these unlisted firms to reconsider.

**Table 2. South African SMEs accessing available pre-listing technical assistance from the Johannesburg Stock Exchange**

Percent of surveyed firms indicating they received this assistance prior to listing

	Main Board	SME Board	All Listed Firms
Assistance in understanding financial disclosure requirements	20%	43%	33%
Assistance in understanding corporate governance requirements	40%	43%	42%
The exchange did not directly provide this kind of assistance to my firm	40%	43%	42%
Training in marketing and public relations	40%	0	17%
Training in investor relations	20%	0	8%

Source: Milken Institute CFM survey of SMEs in South Africa

Note: Numbers may sum to greater than 100 percent, as some firms relied on more than one type of technical assistance.

## VI. GRADUATING TO THE MAIN BOARD

*In Section VI, we look at whether firms listed on the AltX plan to graduate in the next two years—and why or why not. The JSE permits firms to graduate to the main board, but does not pressure them to do so. AltX firms are split on their future plans to graduate, with a couple firms attracted to the main board due to its deeper market and higher status, while a few other firms were content to remain on the less-demanding AltX.*

Generating an on-ramp for new listings on the main exchange was one of the JSE’s motivations for setting up the AltX, but it was not as important as increasing SMEs’ access to long-term finance. Unlike the exchanges in India and Jamaica, the JSE permits AltX firms to graduate to the main board, but typically does not require or encourage them to do so.<sup>xxiv</sup> Instead, the JSE allows AltX firms to decide for themselves if and when to graduate to the main board, provided they can meet the main board listing requirements.<sup>78</sup> Firms that wish to move to the main board must apply to the JSE regulatory team to do so.

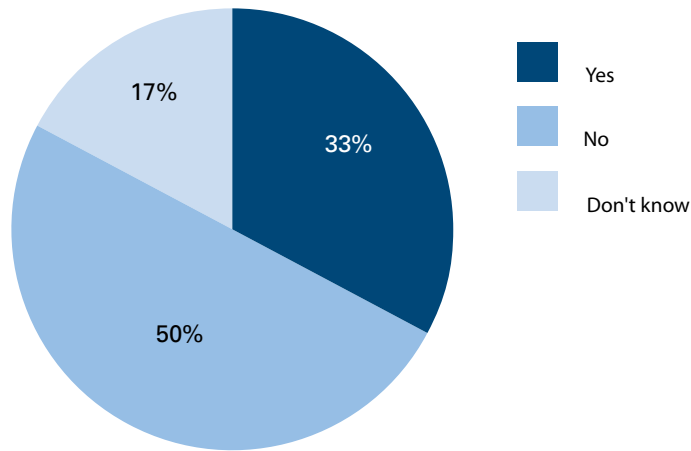
Surveyed AltX firms are split on their future plans to graduate (see Figure 23). Two of the six surveyed AltX firms said they plan to graduate to the main board within the next two years. Both of these firms listed on the AltX within the past five years; one of them also qualified for a main board listing at the time. The two firms mostly shared the same reasons for wanting to graduate to the main board: to access a broader investor base; to raise their valuations; to enhance their profiles as more mature, established companies; and finally, to achieve greater share liquidity. In addition, one of the two firms also specifically cited a desire to attract more institutional investors.

xxiv The Johannesburg Stock Exchange typically uses the term “transfer” in lieu of “graduation”.

Three of the six surveyed AltX firms said they did not plan to graduate within the next two years. These firms' reasons were more diverse. They noted that investors on the AltX are less demanding and, moreover, that their ability to raise funds on the AltX was sufficient. This group also pointed to the main board's higher compliance costs. One firm simply said it did not see any benefit to graduating.

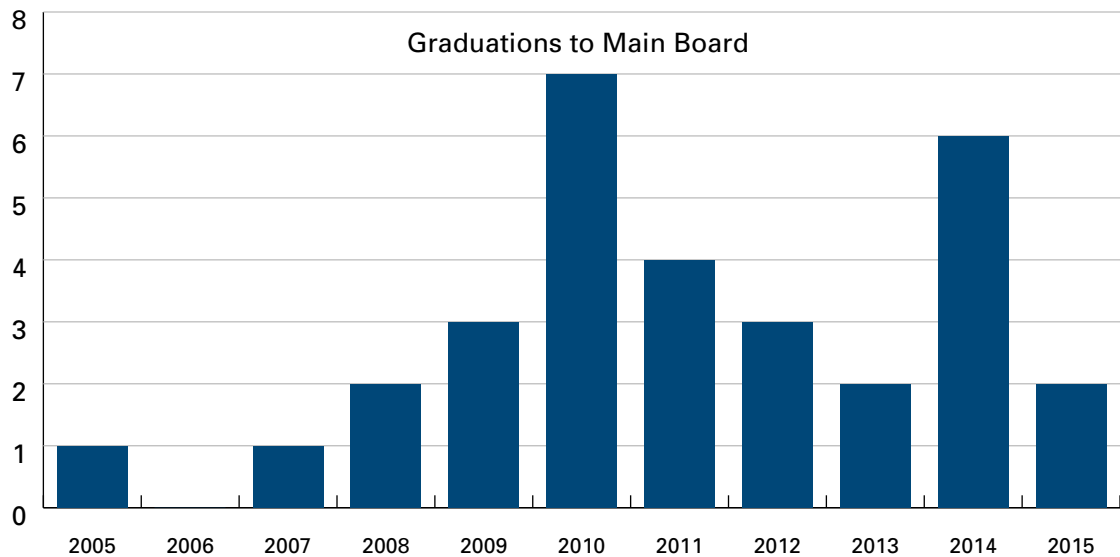
Since its founding, the JSE AltX has facilitated a small but steady stream of graduations, averaging between two and three per year. As of end-2015, the JSE AltX had facilitated 31 graduations, representing about a third of all the firms that have listed since its launch in 2004.

**Figure 23. South Africa: Do AltX firms intend to graduate in the next two years?**  
Percent of firms currently listed on the AltX



Source: Milken Institute CFM survey of SMEs in South Africa

**Figure 24. Annual graduations from the JSE AltX to the Main Board**  
Number of firms



Source: Johannesburg Stock Exchange

## JAMAICA: THE JAMAICA STOCK EXCHANGE'S JUNIOR MARKET

SMEs make up the backbone of Jamaica's economy and by some estimates account for at least 80 percent of new jobs created.<sup>79</sup> Despite their importance to the economy, many SMEs in Jamaica—as in many emerging economies—have difficulty accessing finance, especially on medium- to long-terms at affordable rates. SMEs' inadequate access to affordable finance has negatively affected entrepreneurship and enterprise profitability as well as employment.<sup>80</sup> Just over one-quarter of SMEs had access to a bank loan or line of credit, according to the most recent World Bank Enterprise Survey data.<sup>xxv</sup>

Jamaica's financial market authorities have launched a number of policy reforms and measures over the past several years to enhance SMEs' financial access, with a particular focus on improving financial infrastructure and the regulatory environment. These included initiatives to encourage more bank lending to SMEs by setting up credit reference bureaus and a moveable collateral registry to address information asymmetries and make it easier for firms to pledge collateral.

The important role of SMEs in Jamaica's economy and policy makers' growing awareness of the need to increase their financial access also led to initiatives to expand high-growth potential, medium-sized firms' access to equity capital. This included launch of an SME platform, known as the Junior Market, in 2009, with the overall objective of encouraging investment in Jamaica's "entrepreneurship, employment and economic development."<sup>81</sup> The Jamaica Stock Exchange set up the Junior Market as a platform to expand access to medium- to long-term financing for a subset of eligible SMEs, develop Jamaica's manufacturing sector, and create an on-ramp for the Jamaica Stock Exchange's Main Market (main board). Qualifying SMEs may raise amounts ranging from J\$50 million to J\$500 million (approximately US\$400,000-US\$4 million) on the Junior Market.

Jamaica is among a number of small economies across emerging regions that have taken steps to develop capital markets over the past decade or so. As part of this trend, countries have been taking on more varying approaches including affiliating their small markets with a larger exchange, cooperating with neighboring exchanges in the region, and setting up SME boards. Seeking representation among emerging regions and economies, we selected Jamaica as one of our three focus countries. We also selected Jamaica for its relative progress among countries in the Latin American and Caribbean region in launching an SME board with the encouragement of the Inter-American Development Bank (IDB).

Since 2015, the IDB, in partnership with the Jamaican Stock Exchange, has provided technical and advisory assistance that specifically promotes the Junior Market as an alternate financing mechanism for potential listing candidates: SMEs with high-growth potential deemed "high-impact entrepreneurs."<sup>82</sup> The IDB works with the exchange and prospective SME listing candidates to help them prepare business plans and financial statements. The IDB also helped develop and implement a corporate governance framework for SMEs in Jamaica.

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xxv This was significantly lower than the average of 48 percent for the Latin America and Caribbean region. World Bank, "Enterprise Surveys." Available at <http://www.enterprisesurveys.org/data/exploretopics/finance>.

There were 29 listed companies on the Junior Market at the time of our survey during the fourth quarter of 2016. In line with the stock exchange's aim that the Junior Market should provide an onramp for SMEs to a later main board listing, the Junior Market requires a listed SME to migrate (or "graduate") to the main board once it meets certain criteria (see Section VII). If a company grows to reach a market capitalization greater than J\$500 million, it must either list on the Main Market or, at minimum, pay the ongoing fees for a listed firm on the Main Market even while it remains on the Junior Market. To date, there have not been any graduations from the Junior Market to the main board.

## I. THE DECISION TO LIST

*This section discusses the listing motives of SMEs on the Jamaica Stock Exchange's SME board, the Junior Market, as well as how these motives compare with the exchange's aims for setting up and operating the Junior Market. This market is unique among our study's three focus countries in offering generous tax breaks for listing, which nearly a quarter of surveyed listed firms said was a main listing motive. Nearly a third of listed SMEs said the improved financial reporting and transparency that goes with listing was also among their main motives.*

SMEs were more strongly motivated to list on both the SME and main boards in Jamaica for reasons independent of enhanced financial access—primarily growth-driving and market visibility-raising aims.<sup>xxvi</sup> The most common aim for SMEs listing on the Jamaican Stock Exchange's Junior Market was to position themselves for growth, as cited by just under two-thirds of surveyed firms (see Figure 25). Forty-two percent cited the related aim of improving their competitive advantage. Another closely related aim, improving company or brand reputation, was mentioned as a listing motive by nearly one-third of Junior Market listed firms. This outcome appears to be in synch with the JSE's own listing targeting efforts and its own aims for launching and operating the Junior Market. The market was started based on the expectation that "high impact entrepreneurs" would be attracted to list and expand their businesses.<sup>83</sup>

In terms of specific financial benefits of listing, just under half of surveyed SMEs specifically identified the ability to raise capital at lower cost as one of their top aims for going public. Just under a quarter mentioned the related aim of improving the ability to raise additional finance including from banks. Surprisingly, only 8 percent included improved creditworthiness among their main listing motives. The Junior Market, in contrast, perceives all three of these financial access motives as critical to decisions by SMEs to list. Of course, one of the ways that a firm can position itself for growth—the top-ranking motive SMEs say drove their listing—is through improved ability to raise finance, as well as higher visibility. It is plausible that participating SMEs rated the higher-level strategic aims of growth and heightened market visibility more highly than the motives providing a key means to that end: enhanced financial access.

The Jamaica exchange actively markets itself as an exit vehicle for early-stage investors and this strategy appears to be starting to pay off. Nearly a third of surveyed firms said they listed to provide early-stage investors with an exit.

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xxvi The Jamaica survey sample focused on SMEs listed on the Junior Market. This chapter's findings will reflect that emphasis.

Just under one-quarter of participating SMEs said access to tax breaks was among the main drivers of their listing. This finding is particularly notable because all of these firms specified this motive unprompted—among “other” reasons for driving a listing. At the same time, this finding must be interpreted in the context of uncertainty at the time of the study about the status of generous 10-year tax incentives (which government has recently confirmed will remain in place). Unlike many other SME exchanges, the Junior Market offers tax breaks as incentives to attract listed firms, including 100 percent corporate income tax holiday for the first five years after listing and a 50 percent income tax holiday for the subsequent five years. These incentives are not available to SMEs and other companies that list on the JSE’s main board.

The total impact of this kind of tax incentive on fiscal revenues and the overall economy is difficult to decipher and likely mixed. In the short-term, the listing tax break likely reduces fiscal revenues while in the medium- to long-term, the impact could be mixed, where firms grow and increase their profits and overall taxable base beyond the first five years of the tax break. Tax breaks are controversial, however, when they become the main motive in a listing and there is a risk that they will encourage some less well-suited SMEs to seek a listing. This could potentially deter investors by undermining the quality of investable securities on the exchange. Jamaica has attempted to mitigate some of the concerns associated with listing tax breaks through the requirements firms must meet to get and stay listed and by putting in place harsh delisting consequences including the back payment of all remitted taxes. But it is as yet unclear whether this approach has been successful. (See also Box 10 in Section V below.)

**Figure 25. Main reasons Jamaican SMEs list**

Percent of surveyed firms that include each factor as a top motivation



Source: Milken Institute CFM survey of SMEs in Jamaica

Among the three focus countries for our study, in Jamaica, the largest share of surveyed SMEs (33%, albeit still a minority) considered improved financial reporting and transparency an important listing motive. The Jamaica Stock Exchange mistakenly perceives this as an important motivator to a listing decision. It could be that this listing benefit is only directly apparent to firms with much hindsight. Through well-targeted awareness-raising outreach with current and prospective listed firms, the Jamaica Exchange and other capital markets stakeholders may be able to change SME perceptions about the expected effects of meeting financial reporting and transparency standards. (See also section V.)

## II. LISTED SMES AND ACCESS TO FINANCE

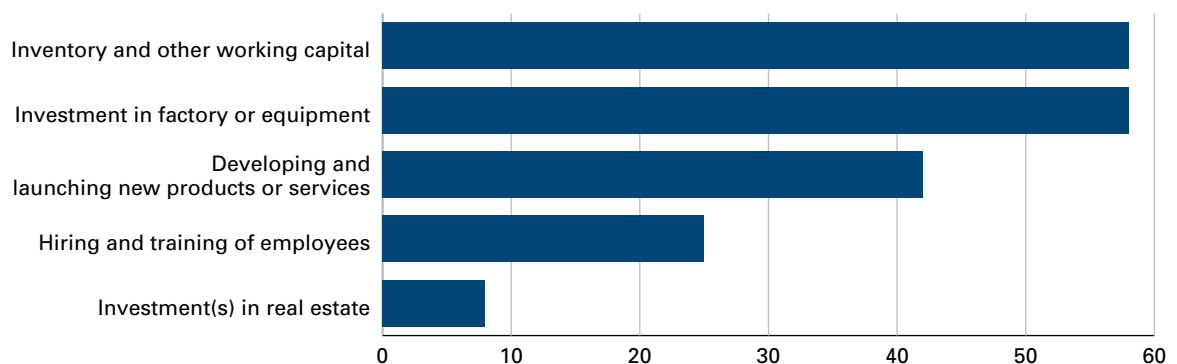
*In Section II, we first look at whether surveyed firms raised capital upon listing and, for those that did, how they used their IPO proceeds. We then analyze how firms accessed additional finance subsequent to listing. We found that all surveyed firms raised capital upon listing and that Junior Market firms allocated their IPO proceeds across a broad range of short- and long-term funding needs. We also found that a majority of Junior Market firms did raise additional capital post-listing, mostly from banks, but also surprisingly often from bond offerings.*

All surveyed Jamaican SMEs listed via an initial public offering and all raised capital at the time of listing. The amounts raised by Junior Market firms at IPO ranged from J\$10 million (about \$90,000) for a firm that listed in 2014 to J\$120.5 million (about \$963,230) for a firm that listed in 2016.<sup>84</sup>

Surveyed firms allocated their IPO proceeds to a broad range of short- and long-term funding needs. Equal majorities of Junior Market firms used at least some of their proceeds either to invest in factories and equipment or to finance inventory and other working capital needs (see Figure 26). About 40 percent of Junior Market firms used a portion of their IPO proceeds to develop and launch new products or services. Most firms used their proceeds for more than one purpose. The vast majority of surveyed firms used some or all of their IPO proceeds to fund long-term investments that they hope will raise their growth potential.

**Figure 26. Use of IPO proceeds**

Percent of Junior Market firms that used some IPO proceeds to fund this expenditure



Source: Milken Institute CFM survey of SMEs in Jamaica

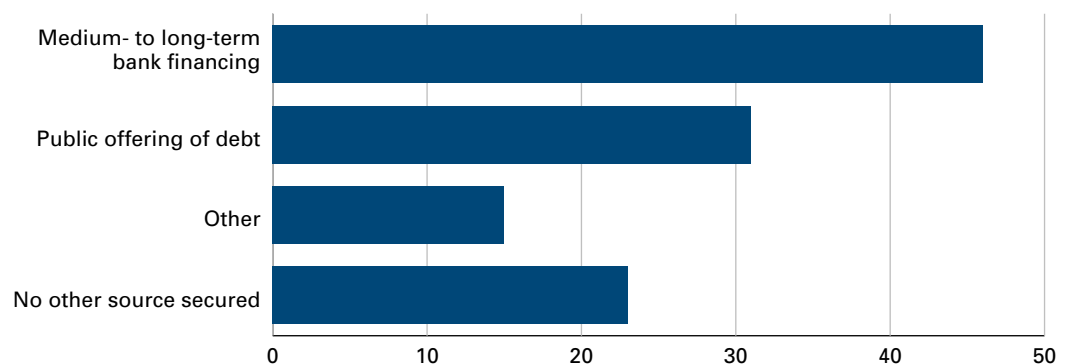


Looking across sectors, most manufacturing firms—which includes the sole main board firm—used some of their proceeds to invest in either factory or equipment or in developing new products. This finding indicates that the Junior Market is facilitating growth-oriented investments in Jamaica’s manufacturing sector—one of its original goals. In addition, three of the four financial firms reported that they used the proceeds to expand their balance sheets and make new investments. The sole technology firm used its proceeds to hire and train staff.

Listing has clearly benefitted the ability of SMEs to raise additional medium- to long-term financing. About three-quarters of surveyed Junior Market firms reported doing so (see Figure 27). About half of all surveyed Junior Market firms, as well as the sole main-board firm, reported securing medium- to long-term bank loans. A quarter have made secondary equity offerings, ranging from J\$100 million to J\$300 million (about \$800,000 to \$2,400,000).<sup>85</sup> Unusually for SMEs across the survey’s three focus countries, about a third of Junior Market firms—most of them from the financial sector—reported raising additional finance through public offerings of debt securities.<sup>xxvii</sup> Unlike in India, no firms received direct funding from the government; and unlike South Africa, no firms reported raising finance through leasing.

**Figure 27. How did listed firms access medium- to long-term finance after going public?**

Percent of Junior Market firms that raised this type of financing post-IPO



Source: Milken Institute CFM survey of SMEs in Jamaica

Importantly, all three Junior Market firms that listed to improve their access to finance have raised additional finance post-IPO. Two of these firms secured bank loans and all three have issued bonds.

### III. ASSESSING THE LISTING EXPERIENCE

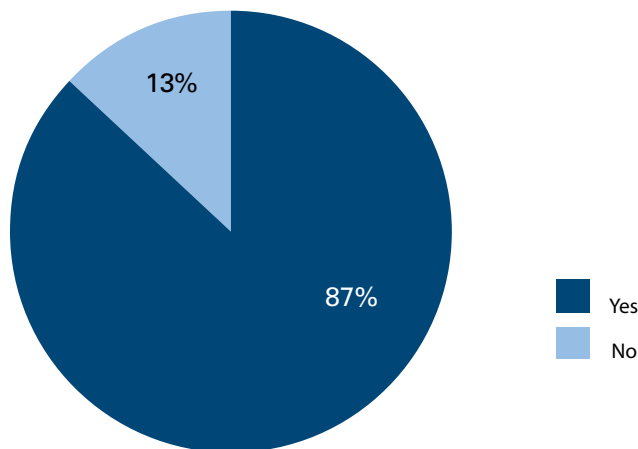
*In Section III, we look at whether, based on their experience, firms would make the same decision to list if they had to do it all over again. This section also details the aspects of listing that have met with or exceeded firms’ expectations before turning to the causes of discontent. Nearly every surveyed firm listed on the Junior Market was happy with its decision to list, making Jamaican firms the most satisfied group of listed SMEs across our three focus countries.*

xxvii The Jamaica Stock Exchange launched its corporate bond market segment in 2013. See World Bank and International Monetary Fund, “Jamaica: Financial Infrastructure Technical Note,” 2015, p. 29.

Around 85 percent of the participating firms on the Junior Market would list again, if given the chance to do things over. One firm was unsure, while one firm regretted its decision and would not list again because of loss of company control. These figures compare very favorably to the findings from India and South Africa.

For firms that were satisfied with their decision to list, the most commonly cited reason was that going public catalyzed improvements in corporate governance and transparency, leading to companies that were better run. In a parallel survey finding, about a third of Jamaican listed SMEs reported that the positive impact of listing on financial performance exceed their pre-IPO expectations, with the rest of the sample saying that listing met expectations in this regard. Together, these finding suggest that the process of listing, for at least some SMEs, does lead to better business practices and improved performance, improvements that would likely also contribute to the wider public policy aims of economic growth and job creation.

**Figure 28. Would SMEs choose to list again?**  
Percentage of surveyed firms listed on the Junior Market



Source: Milken Institute CFM survey of SMEs in Jamaica

Overall, as might be expected given the general satisfaction cited above, a majority of surveyed SMEs on the Junior Market said that the experience of becoming a public company met with or exceeded their expectations across a wide variety of indicators. Firms were particularly satisfied with the outcomes of listing for their visibility and reputation exceeded their expectations. More than 60 percent of firms found the experience of listing to be even better than what they had anticipated in terms of positive public exposure. As noted above in Section I, non-financial benefits, including promotion of the company brand, are among the top reasons SMEs list on the Junior Market.

In two areas—costs associated with meeting ongoing listing requirements and stock price volatility—about a third of listed Jamaican SMEs found that being listed failed to meet their expectations. The issue of volatility is somewhat surprising given that the Junior Market has fairly low levels of trading activity. In fact, the annual turnover ratio for the Jamaica Stock Exchange as a whole, both the main board and the Junior Market, was only 8.7 percent. The issue of ongoing compliance costs likely reflects the fact that SMEs on the Junior Market have to meet the same reporting requirements—both in content and frequency—as do much larger companies listed on the main market. The Junior Market could potentially reduce compliance costs for listed SMEs by moving to a semi-annual, rather than quarterly, disclosure calendar, as the BSE SME Platform in India has done.

**Figure 29. Experience versus expectations for listed Jamaican SMEs**

Key indicators as scored by firms listed on the Junior Market



Source: Milken Institute CFM survey of SMEs in Jamaica

#### IV. HOW UNLISTED FIRMS VIEW LISTING

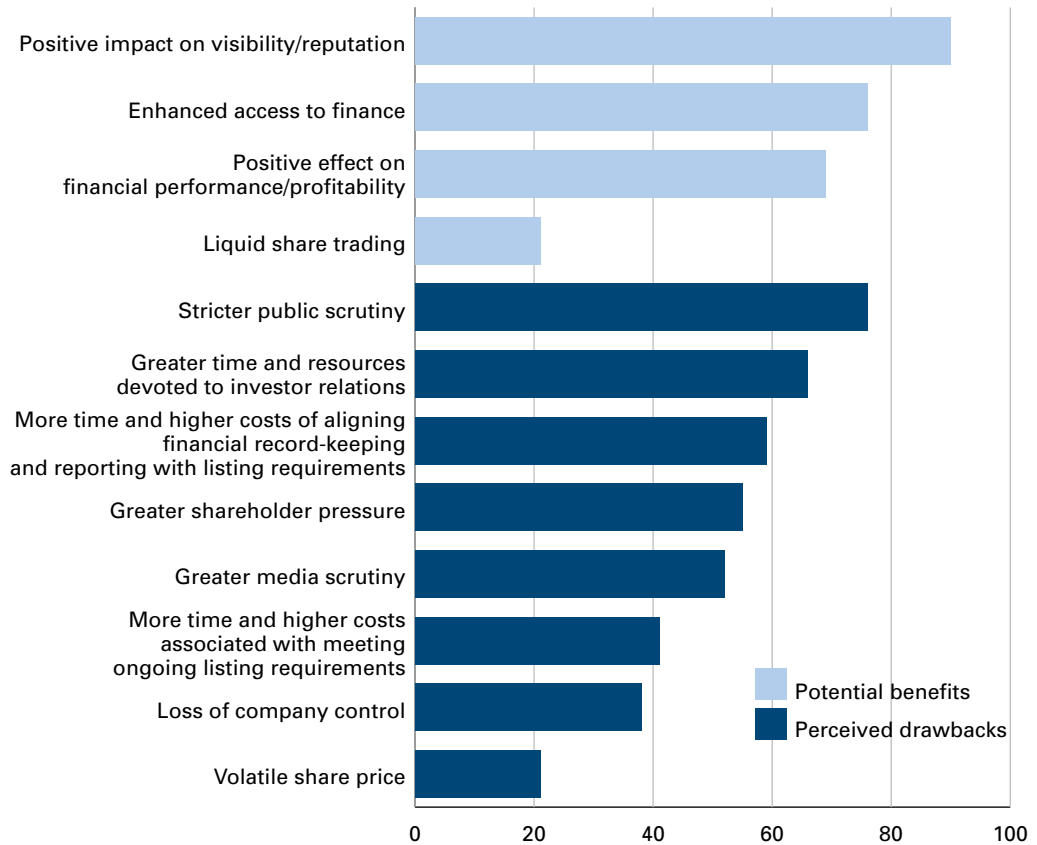
*In Section IV, we review the associations unlisted firms have about becoming a public company. We also look at why firms that could meet listing requirements and considered a listing ultimately decided not to list and at whether or not firms would consider a future listing. In Jamaica, in stark contrast to India and South Africa, 83 percent of surveyed unlisted firms would be willing to consider listing in the future.*

In Jamaica, unlisted SMEs have a surprisingly positive view of the outcomes of a public listing. Ninety percent of surveyed unlisted firms thought listing would have a positive impact on their firm’s visibility and reputation. Moreover, 76 percent thought it would enhance their access to finance, and 69 percent thought it would increase their profitability.

These views reflect the overall satisfaction of SMEs listed on the Junior Market, as detailed above in Section III. The positive associations may also reflect the buoyant press the JSE has received lately. In the year prior to our survey, *Bloomberg* declared that the JSE had “conquered the world”<sup>86</sup> after its market index rose by 97 percent over the year, the fastest rise globally across 93 equity benchmark indices *Bloomberg* tracks.<sup>xxviii</sup>

xxviii The index grew by 97 percent in local currency and 87 percent when converted to U.S. dollars. Local press even compared the JSE to “the world’s fastest sprinter,” Olympic gold medalist Usain Bolt. See Avia Collinder, “Jamaica Tops the World,” *Jamaica Observer*, December 25, 2015. Available at [http://www.jamaicaobserver.com/news/Ja-tops-the-world\\_46932](http://www.jamaicaobserver.com/news/Ja-tops-the-world_46932).

**Figure 30. What unlisted Jamaica SMEs associate with a listing on a stock exchange**  
Percentage of surveyed firms that hold this association



Source: Milken Institute CFM survey of SMEs in Jamaica

Still, the idea of becoming a public company is not entirely rosy for Jamaican SMEs. Three quarters of surveyed, unlisted firms expected that listing would lead to greater public scrutiny, the flipside of the positive implications for firm visibility experienced by listed firms, as discussed above. Two thirds of surveyed, unlisted firms expected that going public would mean devoting more time and resources to investor relations, and 59 percent anticipated they would need to devote more time and money to meeting listing requirements.

Among our sample, 79 percent of unlisted SMEs had previously considered joining the stock exchange. The majority of this subgroup were unable to move forward because they did not meet minimum listing thresholds. The others, which amounted to ten firms, met listing requirements but ended up deciding not to list for a variety of reasons. As Figure 31 below shows, a lack of information about listing contributed to the decision-making process of half of this group. Other factors that caused firms to hold off listing included concerns their IPO would underpriced, simple issues of timing, and the weight of listing requirements. No firms reported that they decided not to list because they found better financing elsewhere.

Those that had not considered a listing in the past—21 percent of surveyed unlisted firms—generally indicated that going public was not a good fit for their own vision of the company. One firm, for example, stated that they started as a family business and would not want to give up control. Others noted that their company was simply not ready to list and probably would not meet the requirements.

**Figure 31. Why qualified SMEs decided not to list**

Percentage of firms that met listing requirements, but chose not to list



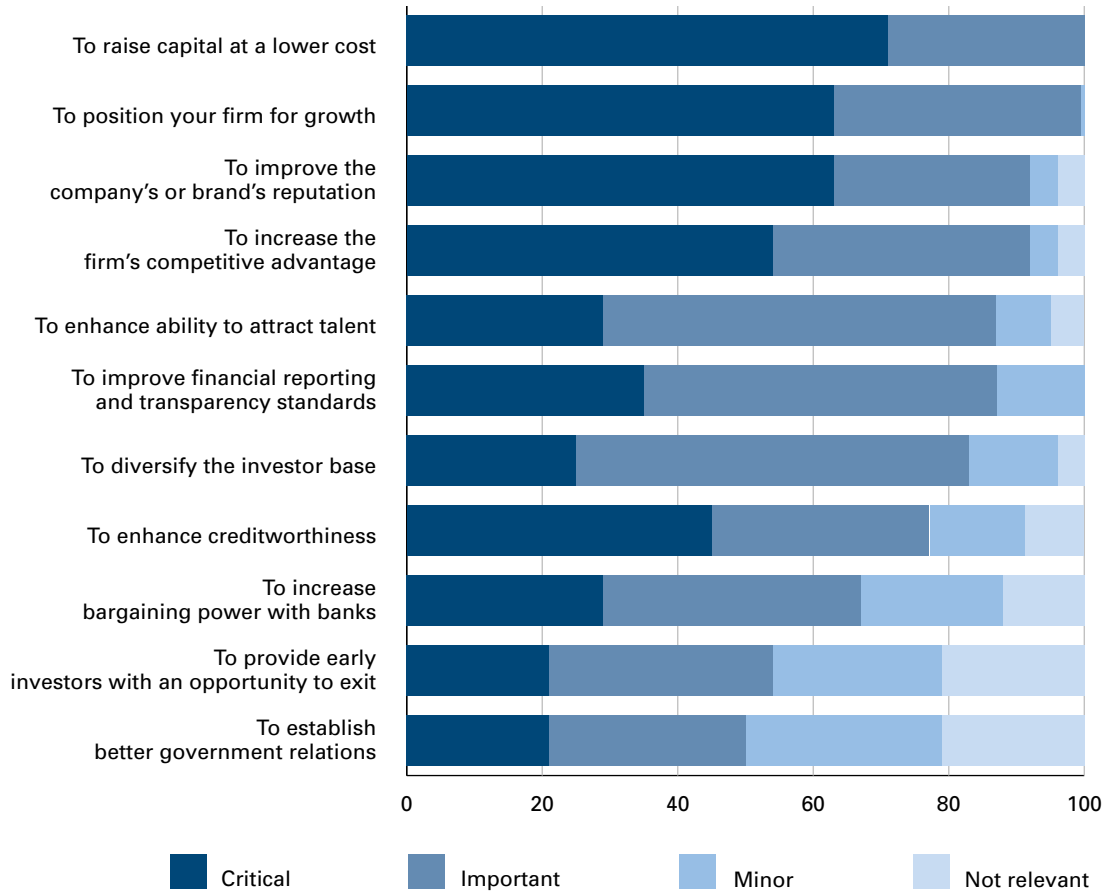
Source: Milken Institute CFM survey of SMEs in Jamaica

Looking forward, 83 percent of unlisted Jamaican SMEs would consider going public in the future. This figure clearly reflects the positive views reported above. It also stands in sharp contrast to findings from India, where no SMEs were considering a future listing, and South Africa, where only a fifth were.

Over 70 percent of unlisted Jamaican SMEs said that raising capital at a lower cost would be critical to their decision to go forward with a future listing. Majorities of unlisted SMEs also cited the related aims of positioning the firm for growth, improving brand and reputation, and improving competitive advantage as critical to whether or not they move forward with a future listing. Notably, increasing bargaining power with banks and creating an exit opportunity for early-stage equity investors were considered minor or irrelevant factors for sizeable percentage of SMEs looking at a possible future listing.

**Figure 32. What are the most important motives that could drive a future listing?**

Percentage of unlisted firms ranking importance of each motive



Source: Milken Institute CFM survey of SMEs in Jamaica

## V. MAKING LISTING MORE ATTRACTIVE

*In Section V, we discuss the kinds of incentives and assistance that SMEs may access to facilitate a listing. We look at the services provided by the intermediaries that work with SMEs planning a listing, and how useful SMEs find this and other available assistance. We also look at how well informed unlisted firms are about what it takes to get and stay listed and the outreach provided by capital markets stakeholders. In Jamaica, a large majority of surveyed, listed SMEs worked with brokers as intermediaries in preparing pre-IPO due diligence and compliance and found these services useful to very useful.*

Although the Junior Market offers generous tax breaks for SMEs that list, it does not otherwise significantly reduce the requirements for being listed compared to the main board beyond a reduced fee structure. The Junior Market does halve initial listing fees and annual exchange fees compared with the main board fees.

Both boards have the same listing requirements and governance standards. Additionally, the frequency of disclosure filing requirements is the same for both boards, each of which mandates quarterly and annual reports on the same content. Reducing reporting frequency for SMEs on the Junior Market may address some of the deterrents that otherwise listing-eligible SMEs have indicated prevents them from listing, without compromising investor protection.<sup>xxix</sup>

A large majority of unlisted, yet listing-eligible SMEs told us they do not see reduced listing time as a change that would facilitate a listing and prompt them to reconsider. Jamaican SMEs have a relatively quick time to market. Surveyed Jamaican SMEs spent an average of five months to prepare a listing, while the Junior Market estimated conservatively it could take up to eight months to prepare a listing. Listing times can range widely by firm.

#### **Box 10. Tax incentives for firms listing on the Jamaican Junior Market**

To attract listings, the Junior Market originally offered listed companies a five-year total income tax holiday and an additional five-years of halved income taxes on corporate profits. Companies must remain listed through the entire tax holiday period plus an additional five years.

Jamaica has attempted to mitigate concerns that tax holidays could risk attracting firms for the wrong reasons or for only the period of the tax holiday. Firms that delist during the five years after expiry of the tax holiday would be obliged to pay back taxes from the preceding ten years.

The total impact of this kind of tax incentive is difficult to assess, however, and likely mixed. In the short-term, the tax break likely reduces corporate income tax revenues. In the medium- to long-term, the impact of these tax holidays may be mixed, where firms grow and increase their profits and overall taxable base. Tax breaks are controversial, however, when they become the main motive for listing and if they cause investors to lose confidence in the quality of the listing tier and its securities.

In recognition of the loss of potential government revenues, policymakers began looking for ways to reduce incentives for listing SMEs in 2014. The following year there were only two IPOs on the Junior Market, and in its 2015 annual report, stock exchange officials concluded that “uncertainties surrounding government policies on the incentives” may have deterred firms from listing. As the full set of tax incentives were due to expire, however, at the end of March 2016, six firms issued shares in the first quarter of that year. The government has since reinstated the corporate income tax breaks in response to steady pressure from the Jamaica exchange and other market stakeholders.

Ian McNaughton, the chairman of the exchange, noted in his keynote at the 2017 Regional Investments and Capital Markets Conference in Kingston that listed firms continue to pay a variety of taxes, despite the holiday on corporate income taxes.<sup>87</sup> These include the General Consumption Tax, pay-as-you-earn (PAYE) taxes, and contributions to National Housing Trust and the National Insurance Scheme. In total, McNaughton estimated, companies listed on the Junior Market have contributed J\$1.7 billion (about US\$13 million) to government revenues in the first five years the SME segment’s operation.

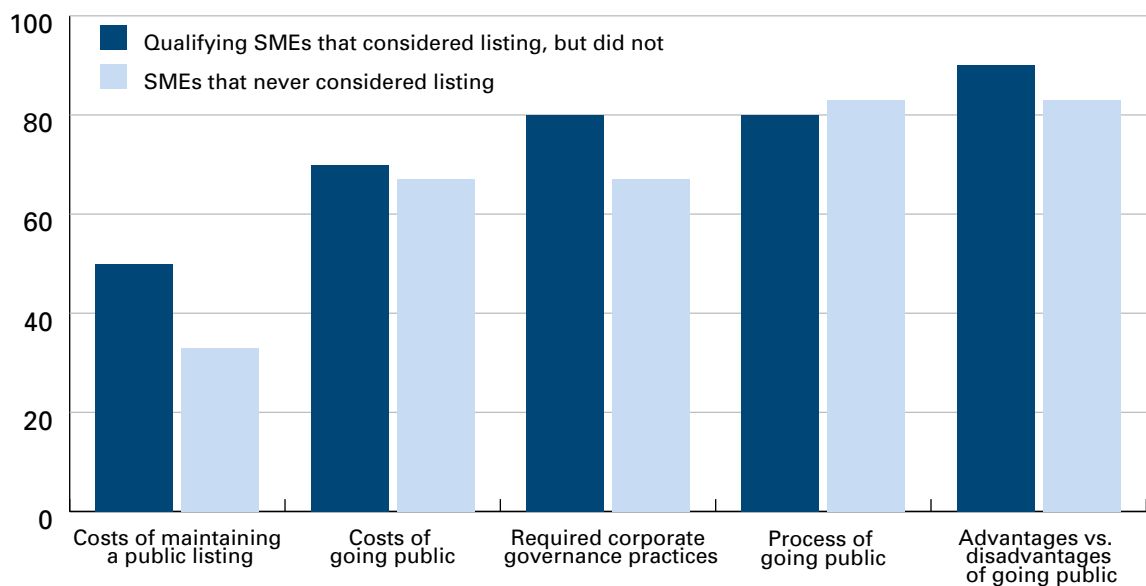
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<sup>xxix</sup> See, e.g., Harwood and Konidaris (2015), who point out that most stock exchanges do not reduce the content of financial disclosure requirements for listings on SME boards because investors expect and require adequate, clear information about SMEs due to their “inherently riskier nature.”

The Junior Market and partner organizations fund education and awareness programs to inform SMEs of the benefits of listing. In particular, the Inter-American Development Bank provides technical and advisory assistance that specifically promotes the Junior Market as an alternate financing mechanism for SMEs and aims to strengthen potentially-listable SMEs to prepare them for listing. In addition, sponsors and investment banks provide some assistance in the form of education and awareness on the process of getting and being listed.

There is a relatively high awareness level overall among unlisted, yet qualifying SMEs about what it takes to get and stay listed. The vast majority of participating unlisted Jamaican firms said they have access to all the information they needed about the positive and negative outcomes of going public. Unlisted Jamaican firms seem to have relatively better clarity than their Indian and South African counterparts specifically about the corporate governance standards that listed firms must meet. In fact, 80 percent of qualifying yet unlisted Jamaican SMEs said they had this information, compared to just over two-thirds in South Africa and 40 percent in India. Surveyed Jamaican SMEs also were relatively better informed about the ongoing listing costs than their counterparts in South Africa and India—although as many as half of Jamaican listing-eligible firms did not feel well informed about this.

**Figure 33. How well informed are unlisted SMEs in Jamaica about going public?**  
Percent of surveyed firms that have sufficient information on certain aspects of listing



Source: Milken Institute CFM survey of SMEs in Jamaica

For those firms that have listed, however, outreach efforts seem to have played almost no role in their decision making. Nearly two-thirds of surveyed firms currently listed on the SME Platform indicated neither the stock exchange nor any other party had actively reached out ahead of the firms’ listing to inform them of the benefits of listing. Only one of 13 participating SME Platform listed firms said the stock exchange had contacted them ahead of listing to explain listing’s benefits. Two surveyed, listed firms indicated investment banks and sponsors had reached out to pitch them on listing’s benefits.



The majority of SMEs listed on the Junior Market reported that they did not receive any technical assistance from the exchange prior to their IPO. A handful received assistance understanding corporate governance and financial disclosure requirements, and these firms did find the information helpful, according to survey results.

Looking forward, SMEs that could have listed but decided not to do so indicated that technical assistance or capacity building to help them prepare a listing would make them more likely to reconsider. A majority of these firms also said that tax incentives may motivate them to list. This latter finding must be interpreted in the context of developments at the time of fielding the survey, however—which occurred during a time when the status of 10-year corporate tax breaks came into question. In October 2016, the Jamaican legislature passed the Income Tax (Amendment) Act, which maintained the incentives provided to firms listing on the Junior Stock Exchange (see Box 10 above).

#### **Box 11. Junior Market SMEs valued pre-listing assistance of authorized intermediaries**

Jamaica's Junior Market—as with the SME Platform in India and the AltX in South Africa—requires that SMEs preparing to list work with authorized intermediaries. These intermediaries, which must be licensed brokers in the case of Jamaica's Junior Market, assist SMEs with a wide range of functions in the pre- and post-listing process.

The vast majority of surveyed Junior Market firms found the assistance they accessed from authorized intermediaries useful to very useful in preparing to list. Three quarters of Junior Market SMEs participating in our study said they worked with these intermediaries in ensuring compliance with listing, disclosure and governance requirements and pre-IPO due diligence. Two-thirds of participants said they worked with authorized intermediaries in preparing IPO documents. Around six in ten surveyed SMEs on the Junior Market accessed legal advice.

Notably, unlike in India and South Africa, the Jamaican authorized intermediaries are only required to assist firms up until the moment of listing. Moreover, unlike in India, authorized intermediaries do not have to keep a percentage of the firm's stock on their books.

## **VI. GRADUATING TO THE MAIN BOARD**

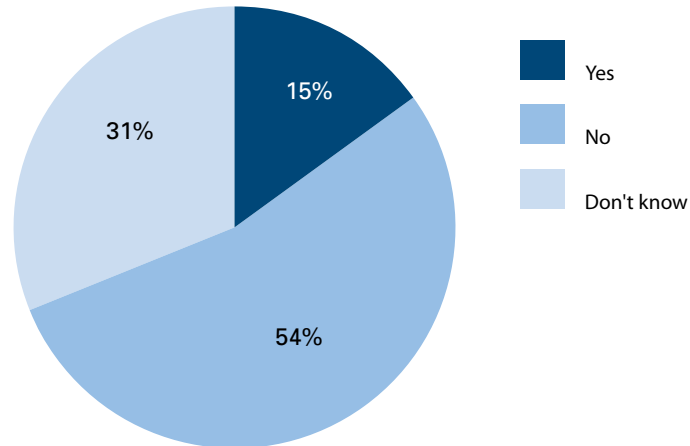
*In Section VI, we describe the policies that govern when Junior Market firms may graduate to the main board. We also examine whether these firms actually wish to graduate—and why or why not. The Jamaica Stock Exchange designed the Junior Market to function, in part, as an on-ramp to the main board. However, we found that Junior Market firms were, for the most part, reluctant to graduate onto the main board. Many found the Junior Market adequate to their needs and did not wish to incur the higher costs (including foregone tax breaks) associated with listing on the main board.*

One of the Jamaica Stock Exchange's goals in setting up the Junior Market was to create an on-ramp for new listings on the main board. As such, the graduation process has some automaticity built into it (see Box 12). Firms listed on the Junior Market will eventually be compelled to graduate, even if they do nothing.

Most surveyed firms on the Junior Market either did not intend to graduate in the next two years or were ambivalent about doing so (see Figure 34). Of the thirteen surveyed Junior Market firms, just two planned to graduate to the main board in the next two years. Seven said they did not plan to do so, and four were unsure.

**Figure 34. Jamaica: Do Junior Market firms intend to graduate in the next two years?**

Percent of firms listed on the Junior Market



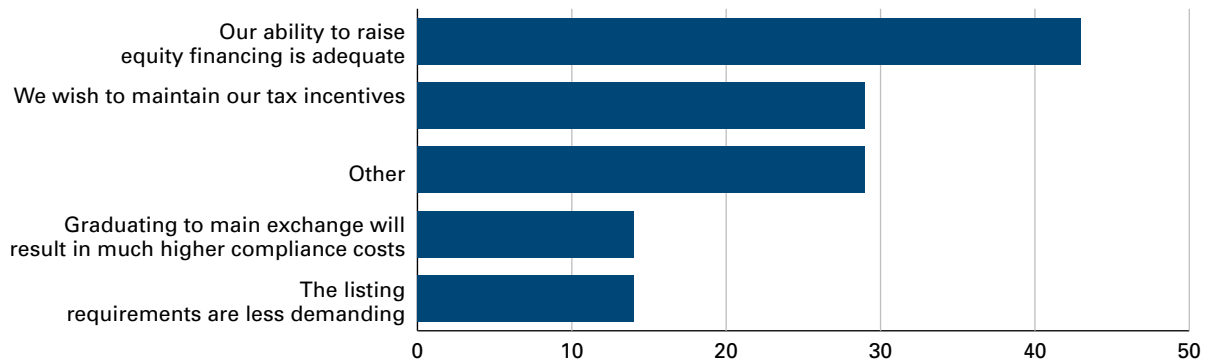
Source: Milken Institute CFM survey of SMEs in Jamaica

Firms that do intend to graduate are drawn to the main board by the greater prominence that they believe a listing on that segment confers. The two firms that plan to graduate shared a desire to be seen as mature, established firms, and hoped that graduation would raise their profile and burnish their corporate image. Interestingly, neither of these two firms said they were motivated by direct financial considerations, such as greater liquidity or a richer share valuation—though one did mention that the phase-out of tax incentives was a factor in its decision (see more on the phase-out of tax incentives in Box 10 above).

Firms that do not intend to graduate in the next two years reported that they were satisfied with the Junior Market and saw no need to incur the higher costs (including foregone tax breaks) associated with listing on the main board (see Figure 35). Among the seven firms that do not plan to graduate, the most common reason why not (given by three of the firms) was that they were satisfied with their ability to raise funds on the Junior Market. Additional costs—direct and indirect—were also a factor: two firms were concerned about losing their tax breaks; one firm was concerned about higher compliance costs; and one firm was put off by the higher listing fees. These survey findings may support the JSE's decision to limit the time firms can spend on the Junior Market to no more than 10 years. At the same time, however, the tax credits may dis-incentivize firms from graduating early, even if they are otherwise able to do so. As of the fourth quarter of 2016, no Junior Market firms had yet graduated to the main board.

**Figure 35. Jamaica: Why some Junior Market firms don't intend to graduate in the next two years**

Percent of Junior Market firms that do not intend to graduate that cite this reason



Source: Milken Institute CFM survey of SMEs in Jamaica

**Box 12. Graduation process and phase-out of tax incentives**

Firms are *permitted* to graduate to the main board after five years on the Junior Market.<sup>88</sup> Firms are expected to graduate after 10 years on the Junior Market. In addition, if a firm's subscribed equity exceeds J\$500m (about US\$4m), it must either graduate or, at a minimum, begin paying listing fees equivalent to those on the main board.<sup>89</sup>

To encourage the Junior Market's development, the Jamaican government grants firms that list on the Junior Market relief from corporate income taxes.<sup>xxx</sup> This relief is withdrawn in phases: in their first five years of being listed, firms qualify for a 100 percent corporate income tax remission; in their second five years, a 50 percent remission. After 10 years, the tax relief is withdrawn altogether.

Companies that delist within 15 years of listing are required to repay their tax breaks to the government.<sup>90</sup>

xxx It is unusual for governments to offer tax incentives to SME issuers, as opposed to investors (see: IOSCO Growth and Emerging Markets Committee, "SME Financing through Capital Markets," 2015, p. 56). Jamaica offers both: in addition to the tax incentives for issuers, Jamaica also fully exempts investors in Junior Market stocks from dividend and capital-gains taxes (see Jamaica Stock Exchange, "Junior Market Executive Summary," 2012, p. 4). The IMF has cautioned against the use of tax incentives for issuers, arguing that they are vulnerable to abuse; as an alternative, it has suggested that Jamaica focus on tax incentives for investors (see International Monetary Fund, *Staff Report for the 2016 Article IV Consultation, Eleventh and Twelfth Reviews Under the Extended Fund Facility and Request for Modification of Performance Criteria*, 2016, pp. 18 and 50). The Jamaican government has argued that the tax incentives have been "instrumental" in getting companies to list on the Junior Market (IMF, 2016, p. 20).

Few studies have asked SMEs themselves why they list (or why not)—and how the experience of getting and staying listed could be improved. Through a survey instrument created jointly with the World Federation of Exchanges (WFE), we carried out evidence-based research to compare how approaches to SME boards have varied across countries. We surveyed listed SMEs on the SME boards and main markets in three countries—India, Jamaica, and South Africa—to compare their main motives in listing, whether they gained better access to finance, and whether their post-listing experience has met their expectations. We looked at whether, and to what extent, SME platforms are incubating and preparing SMEs for later listings on the main board. We also surveyed unlisted, yet qualifying SMEs to understand their reasons for deciding against a listing and their perceptions of what “going public” means.

In launching this research, we began with the premise that an appropriate country context is an important starting point. A stable macroeconomic environment and predictable policies, as well as an effective supervisory and regulatory regime, are prerequisites to well-functioning capital markets. In identifying several key, cross-cutting lessons, our evidence-based findings focus on the perspectives of listed and unlisted SMEs themselves.

Our findings provide further support to arguments in the existing literature that public equity listings typically are better suited for companies with certain characteristics—specifically, those with high-growth potential, ideally operating in sectors considered strategic to overall economic development. It is also imperative that firms seeking to list have the institutional capacity to handle the financial reporting and corporate governance requirements.<sup>91</sup> By identifying and cultivating this subset of SMEs for listing, SME platforms increase the likelihood that they will generate sufficient trading activity and liquidity and serve as an incubator for later main board listings.

In some contexts, however, the potential pool of SMEs that meet these criteria may be too shallow to justify the expense of establishing an SME board altogether. Policymakers in emerging economies that want to see SME exchanges succeed will also need to embrace policies that develop a thriving private sector. In addition to a stable macroeconomic environment and sound institutions, this requires an operating environment that allows businesses to thrive, invest, and grow.

Stock markets are not just for raising capital. The SMEs participating in our study listed for a variety of reasons, and the relative importance of these reasons in driving that decision differed across the countries. Stock exchanges that are closely attuned to the various reasons SMEs list may be able to sharpen their appeal to attract new candidates to their SME platforms.

It is important that SME exchanges correctly understand the priorities and perceptions of the firms that list. We found that SME exchanges are largely in tune on these issues with the firms that would make the best candidates for public offerings in their markets. However, some knowledge gaps remain.

For example, stock exchange managers in all three focus countries may overestimate the importance that SMEs attribute to improved financial reporting and transparency as a direct benefit of listing. Relatively few listed SMEs that we surveyed actually consider the opportunity to improve financial reporting a main motive for listing. Stock exchanges could engage in more educational activities that emphasize that improving financial reporting and corporate governance are themselves the gateway through which firms achieve the other benefits of listing, including accessing a wider pool of investors and improving overall firm performance.

By addressing these knowledge gaps, stock exchanges and other capital markets stakeholders could, in some cases, make outreach more effective. It could also ensure that exchanges are tailoring their services and processes to the needs of issuers as much as possible.

At the same time, SME exchanges may not always be able to address all of the factors and concerns that dissuade eligible firms from listing, where these exist. For example, loss of company control and heightened public scrutiny are unavoidable outcomes of listing.

The stock exchanges in all three focus countries provide education and awareness outreach on listing's benefits to SMEs, often in collaboration with other partners. However, awareness of this outreach was relatively low among listed SMEs participating in our study. Targeted and clear communication to prospective listing targets about the costs and requirements of getting—and staying—listed would better equip them more of them with the information they need to make a well informed decision. We found that confusion among unlisted SMEs about the ongoing costs of being listed could be as much a deterrent to some firms as the actual financial and operational costs.

Exchanges do not have to “give away the keys to the store” when it comes to disclosure and corporate governance requirements—nor should they. Findings for our study's focus countries also support recommendations in the existing literature that SME boards should reduce disclosure frequency, rather than content.<sup>92</sup> The BSE SME Platform only requires semi-annual disclosures, and yet firms listed there reported improved access to finance and better financial performance as outcomes of listing as often as did firms on the main market. Furthermore, South African and Jamaica firms listed on SME boards—where they faced the same quarterly filing requirements as firms on the main board—were more likely than their Indian peers to report that the costs of maintaining a listing were more severe than they had anticipated prior to going public. Reduced reporting frequency could alleviate some of these costs.

Services and assistance provided by authorized intermediaries, such as designated advisors, can make a real contribution to improving the odds of a successful listing. Surveyed listed companies in all three focus countries reported that such assistance was useful in preparing for the rigors of a public listing. In some countries, such as India, authorized intermediaries help source new issuers, a vital role in ensuring future market activity on the SME segment. Enlisting intermediaries in stock exchanges' targeted outreach efforts to appropriate companies could be an effective way of disseminating knowledge and addressing concerns about the benefits and overall impact of going public.

Most surveyed firms accessed additional medium- to long-term financing subsequent to their IPO. These findings lend support to the idea that when firms improve corporate governance and financial reporting in order to meet listing criteria, they can also improve their ability to access finance from banks and other sources. However, this finding should be interpreted carefully since many of the firms that choose to list may have been more financially sound and have better growth prospects than their unlisted counterparts. By implication, the former group of firms may already be in a better position to raise external finance even before they list.

A strong government commitment can strengthen SME exchanges. Both the BSE's SME Platform and Jamaica's Junior Market have benefited from their respective government's commitment. In India, this support included new securities regulations specifically tailored for public equity listings by smaller companies. The establishment of the Jamaican Stock Exchange's Junior Market was a collaborative effort among the Jamaican government, the Board of the JSE, the Financial Services Commission, and a steering committee composed of key stakeholders.

Targeted tax incentives may be one way to generate listings, at least in the short- to medium-term. Unlisted, yet qualifying SMEs across all three countries said that introducing tax incentives for listed firms could motivate them to consider listing. But it is still unclear how effective these incentives are as part of a longer-term strategy for developing well-functioning capital markets.

It is clear, however, that tax incentives may cause complications for policymakers later on. Once in place, they can be politically difficult to retract. There is a lack of comprehensive information from countries' experiences on the use and impact of tax incentives intended to attract listings. The total impact on fiscal revenues and the overall economy is difficult to decipher and likely mixed. In the short-term, tax breaks likely reduce fiscal revenues. Over the longer-term, as firms grow, there could be a more positive impact on fiscal revenues. Tax breaks are likely counterproductive in cases where they become the main motive in a listing, particularly if they reduce investor confidence in the quality of the listing tier. This is a specific issue that would benefit from focused, comprehensive research and monitoring.

Another issue that merits further focused study is whether it is useful for an SME exchange to employ a structured means of ensuring that firms transfer to the main board—such as requiring migration once certain criteria are met (e.g., growing beyond a certain size). That said, exchanges also have less coercive tools to employ to address reluctance on the part of firms to graduate to the main board. If an exchange wants to persuade firms to graduate to the main board, it may do so by appealing to financial and reputational considerations, as well as the advantages of a more diversified investor base typically offered by main boards. It also could be useful for stock exchanges to explore whether initiatives such as focused technical assistance could help prepare firms for graduation.



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