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SMEs AND THE CHALLENGE TO GO PUBLIC: EVIDENCE FROM A RECENT SURVEY

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SMEs And The Challenge To Go Public

Evidence from a Recent Survey

by

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January 2012

Abstract:

Italian SMEs go public much less than SMEs located in other European countries, even though their relevance for the national economy is relatively higher in terms of employment and value added. Why do Italian SMEs so scarcely rely on equity as an external source of finance, despite the option of getting listed on SME-dedicated stock market segments? In this paper we address this question by analyzing the responses to a questionnaire that we submitted to a sample of listed firms and institutional investors. We also suggest policy interventions to provide Italian SMEs with the appropriate incentives for listing.

Keywords: SMEs, IPO, equity financing, financial constraints

JEL codes: G1, G3

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1. Introduction

Small and Medium Enterprises (SMEs) are key contributors to employment and growth. For example, considering a sample of 99 countries in the time interval 2006-2010, Ayyagari et al. (2011) found that SMEs employed on average the 66% of total workers; even considering a restricted sample of industrialized countries (EU-27), the contribution of SMEs to total employment was again 66%.

Given the economic relevance of SMEs, their difficulties in accessing funds are a crucial issue for both policy makers and researchers worldwide. However, the relative share of external and internal sources of funds and the role of bank credit versus equity financing vary across countries, as shown by Beck et al. (2008). So, both scholars and policy makers have focused on the role played by institutional, financial and legal environments in explaining SME difficulties across countries.

Interestingly, Italian SMEs go public much less than SMEs located in other European countries, even though their relevance for the national economy is relatively higher in terms of number of firms, employment and value added. The objective of this paper is to explore why Italian SMEs rarely rely on equity as an external source of finance, i.e. they rarely go public, despite the option of getting listed on SME-dedicated stock market segments. We also aim at suggesting policy interventions to provide SMEs with appropriate incentives for listing.

The decision of going public is still an open issue in corporate finance; moreover, since this decision depends on a large set of potential determinants, there is no theoretical model capable of capturing the role played by all of them. That is why we decided to investigate the “paradox” of Italian SMEs (that is, the paradox of SMEs playing a key role in the national economy and simultaneously being rarely listed on regulated markets) through a questionnaire: in particular, we submitted it to a sample of listed firms and institutional investors to understand both the decision of firms of going (or not going) public and the decision of investors of allocating (or not allocating) their funds into SMEs.

This paper is organized as follows: the second section contains a brief analysis of the economic relevance of European SMEs; the third section describes the differences among dedicated institutional frameworks for listing across Europe; the fourth and the fifth sections focus on Italian listed SMEs and institutional investors respectively; the sixth section describes the structure of the questionnaire, the surveyed sample, and the main results; the seventh and the eighth sections summarize recent policy interventions and suggest new ones to facilitate the access of Italian SMEs to regulated markets; finally we offer our conclusions.

2. The economic context

SMEs represent a dominant share of the industrial structure of European countries, in terms of number of firms (over 99%) and employees (over 65%); their contribution to value added is also very significant, close to 60% of the overall value added. Within SMEs, the breakdown into micro, small and medium enterprises allows to identify some important features: micro firms (i.e. those with fewer than 10 employees) play a central role, amounting to 92% of the total number of enterprises, producing about 22% of total value added, and accounting for about 30% of total labor force (Table 1).

Table 1: Enterprise size class analysis of key indicators, EU-27, 2008

	Number of enterprises	Persons employed	Value added
	(mln)		(EUR 1 000 mln)
All enterprises	21,0	135,8	6.176
All SMEs	20,9	90,6	3.617
Micro	19,3	39,3	1.348
Small	1,4	27,9	1.147
Medium	0,2	23,4	1.122
Large	0,04	45,2	2.559
	Number of enterprises	Persons employed	Value added
	share in total (%)		
All enterprises	100,0	100,0	100,0
All SMEs	99,8	66,7	58,6
Micro	92,0	29,0	21,8
Small	6,7	20,5	18,6
Medium	1,1	17,2	18,2
Large	0,2	33,3	41,4

Size classes based on number of employees: micro = 1-9; small = 10-49; medium = 50-249; large = 250 or more. Financial firms are excluded. *Source:* Eurostat.

Across country analysis over EU member states shows that both similarities and differences exist:

- Similarities: SMEs are about 99% of the total number of firms, with a largely prevailing share of micro enterprises, a small share of small firms and an even smaller one of medium firms (Table 2).

- Differences:
 - The percentage of micro-enterprises significantly varies across countries, with countries like Greece, Italy, Portugal, Spain, and France having more micro firms than the 92% EU-27 average, and other countries, including Germany and United Kingdom, having less micro firms than the 92% EU-27 average;
 - As for the number of workers employed by SMEs (Table 3), some countries are well above the 67% EU average (Greece, Italy, Portugal, and Spain), while other countries are below such average (France, Germany, and United Kingdom);
 - As for the value added (i.e., the gross operative income), the contribution of micro firms is relatively higher in those countries with a larger share of employees at SMEs (Greece, Italy, Portugal, Spain) with respect to others (France, Germany and United Kingdom), as shown in Table 4.

Table 2: Number of enterprises by size, 2008

	Total number of enterprises (thousands)	Micro	Small	Medium	All SMEs	Large
		(%)				
Greece	811	96,6	3,0	0,4	99,9	0,1
Italy	3.947	94,3	5,1	0,5	99,9	0,1
Portugal	778	94,0	5,1	0,7	99,9	0,1
Spain	2.653	93,1	6,0	0,8	99,9	0,1
Sweden	586	94,7	4,4	0,8	99,8	0,2
France	2.633	93,1	5,9	0,9	99,8	0,2
Belgium	426	92,5	6,3	0,9	99,8	0,2
EU-27	20.994	92,0	6,7	1,1	99,8	0,2
Netherlands	583	90,4	8,0	1,4	99,7	0,3
Ireland	158	87,8	9,9	1,9	99,7	0,3
Finland	202	91,7	6,9	1,1	99,7	0,3
Austria	294	87,2	10,8	1,7	99,6	0,4
United Kingdom	1.731	89,3	8,8	1,5	99,6	0,4
Denmark	211	85,0	12,2	2,4	99,6	0,4
Germany	1.880	83,0	14,1	2,4	99,5	0,5

Size classes based on number of employees: micro = 1-9; small = 10-49; medium = 50-249; large = 250 or more.

Financial firms are excluded. *Source:* Eurostat, European Commission.

Table 3: Number of employees (%) by size of enterprises, 2008

	Micro	Small	Medium	All SMEs	Large
Greece	57%	17%	11%	86%	14%
Italy	46%	22%	12%	81%	19%
Portugal	39%	23%	17%	79%	21%
Spain	39%	23%	15%	76%	24%
Ireland	23%	26%	24%	73%	27%
Austria	25%	23%	19%	67%	33%
Belgium	29%	21%	16%	67%	33%
EU-27	29%	21%	17%	67%	33%
Denmark	17%	25%	24%	66%	34%
Netherlands	25%	21%	19%	66%	34%
Sweden	26%	21%	18%	65%	35%
Finland	25%	20%	17%	61%	39%
Germany	19%	22%	20%	61%	39%
France	24%	20%	16%	61%	39%
United Kingdom	20%	16%	16%	51%	49%

Size classes based on number of employees: micro = 1-9; small = 10-49; medium = 50-249; large = 250 or more.

Financial firms are excluded. *Source*: Eurostat, European Commission.

Table 4: Value added* by size of enterprises, 2008

	Micro	Small	Medium	ALL SMEs	Large
Greece	36%	21%	16%	72%	28%
Italy	32%	23%	16%	71%	29%
Portugal	23%	23%	22%	68%	32%
Spain	28%	22%	17%	67%	33%
Netherlands	28%	19%	19%	66%	34%
Denmark	19%	21%	21%	62%	38%
Austria	19%	20%	21%	60%	40%
Belgium	20%	21%	19%	60%	40%
<					

European rules,² aimed both at creating a consistent business environment for SMEs throughout Europe and at promoting growth, competitiveness and job creation. One of the fundamental problems that SMEs have to face is funding: the constraints on bank credit, more binding after the 2007-2009 financial crisis, and the further potential restrictions, which might be produced by the new Basel III framework, urge both firms and policy makers to rethink the role of bank debt and to search for alternative sources of funds.

A survey on SMEs³ published in December 2011 by the European Commission found that access to finance is the second top concern of European SMEs: in fact, while almost two-thirds (63%) of the European SMEs who applied for a bank loan during the last six months of 2011 received the whole amount they asked for (vs. 77% for large firms)⁴, 11% of them were not funded at all, and 17% of them received less than the amount they applied for; moreover, 4% of SMEs declined the loan offer from the bank because the financial conditions were considered unacceptable. So, almost one-third of European SMEs applying for bank loans did not receive funding.

In the same time interval, while 75% of European SMEs made use of debt financing (Figure 1), only 7% of them accessed equity financing (Figure 2)⁵; it is worth noticing that equity financing is particularly low in countries where SMEs play a relatively more important role, such as in Italy (3%), Spain (3%), and Portugal (2%).

the European Parliament, the Council, Economic and Social Committee and the Committee of the Regions, Review of the "Small Business Act" for Europe, Brussels, 23.2.2011, COM(2011) 78 final.

² In particular:

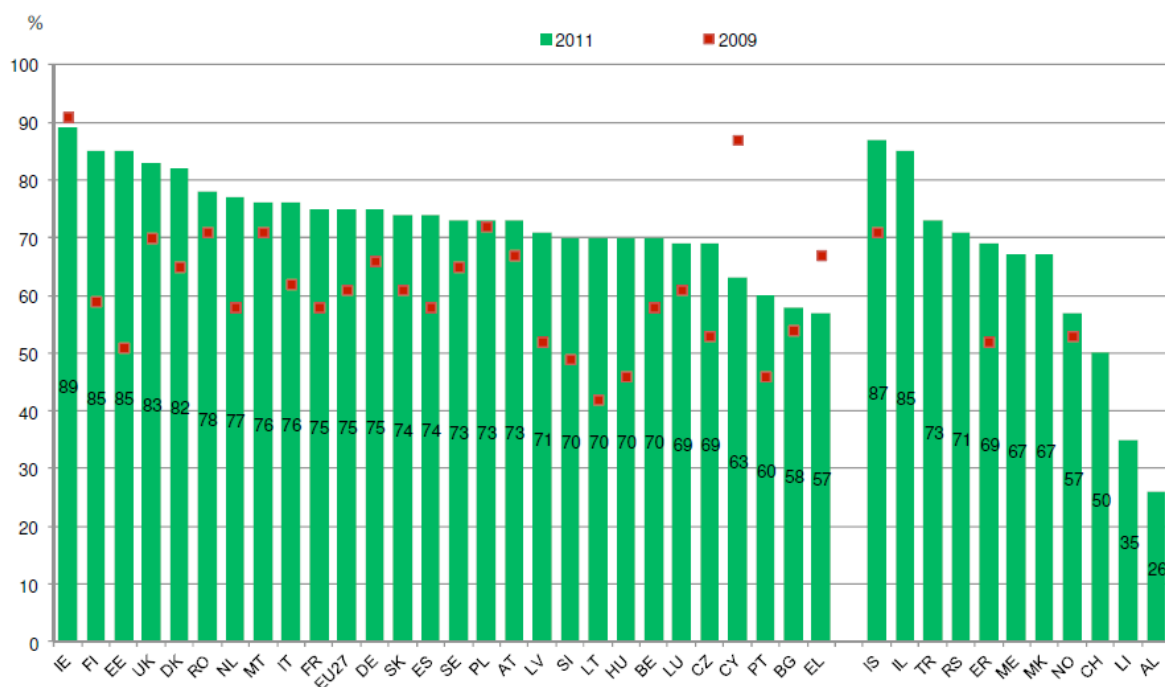
- 1) Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded;
- 2) ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance;
- 3) design rules according to the "Think Small First" principle;
- 4) make public administrations responsive to SMEs' needs;
- 5) adapt public policy tools to SME needs: facilitate SMEs' participation in public procurement and better use State Aid possibilities for SMEs
- 6) facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions;
- 7) help SMEs to benefit more from the opportunities offered by the Single Market;
- 8) promote the upgrading of skills in SMEs and all forms of innovation;
- 9) enable SMEs to turn environmental challenges into opportunities; 10) encourage and support SMEs to benefit from the growth of markets.

³ SMEs are defined in the report as firm with 1-249 employees. 15,150 interviews were conducted across 38 countries, of which 13,859 interviews across the EU 27 countries, between 22nd August 2011 and 7th October 2011. Sampled firms belong to the following sectors: mining and quarrying, manufacturing electricity, gas and water supply, construction, wholesale and retail trade, hotels and restaurants, transport, storage and communication, real estate, renting and business activities, education, health and social work, other community, social and personal service. Enterprises of the following sectors are not included: agriculture, fishing, public administration, financial services, activities of households, extra-territorial organizations and bodies, holding companies.

⁴ Based on a survey of 91 banks in 45 countries, Beck, Demirgüç-Kunt and Martínez Pería (2008) found a negative bias for SMEs versus large firms in the relationship with banks: the latter are less exposed and charge higher interest rates and fees to SMEs relative to large firms and have higher non-performing loans related to lending to SMEs.

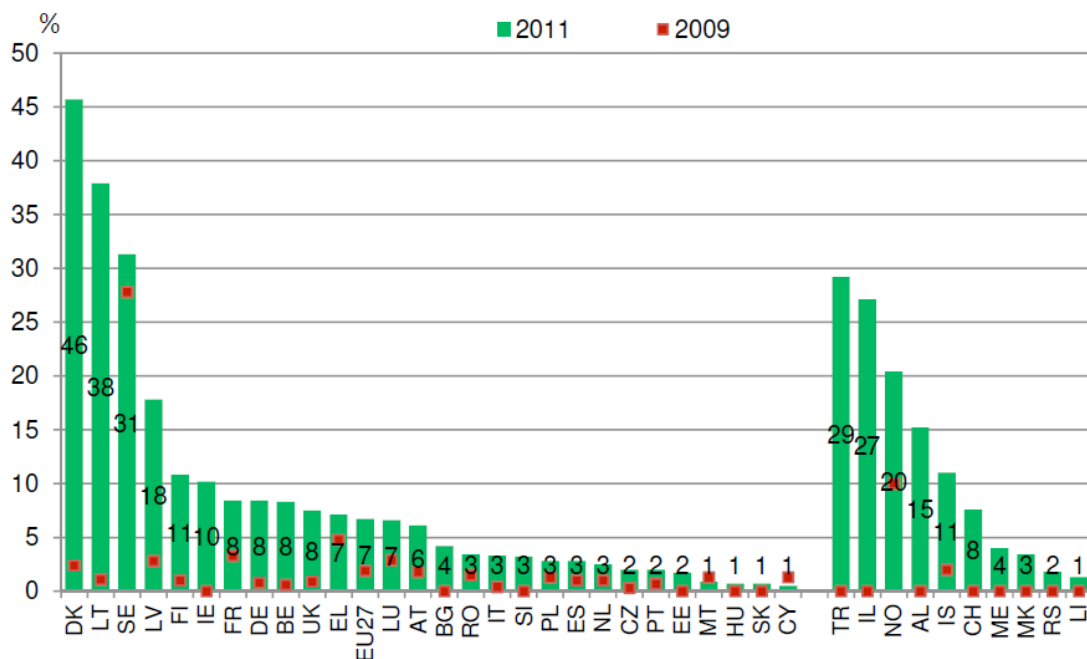
⁵ The survey reports that the share of large firms (250 or more employees) using equity financing is 11%, while the figure rises to 14% for SMEs owned by venture firms; equity financing is reported to be less likely for enterprises with a single owner.

Figure 1: Share of SMEs using debt financing*



*Data referred to last six months before publication of the survey. *Source:* European Commission, *SMEs' Access to Finance, Survey 2011 (December)*.

Figure 2: Share of SMEs using equity financing*

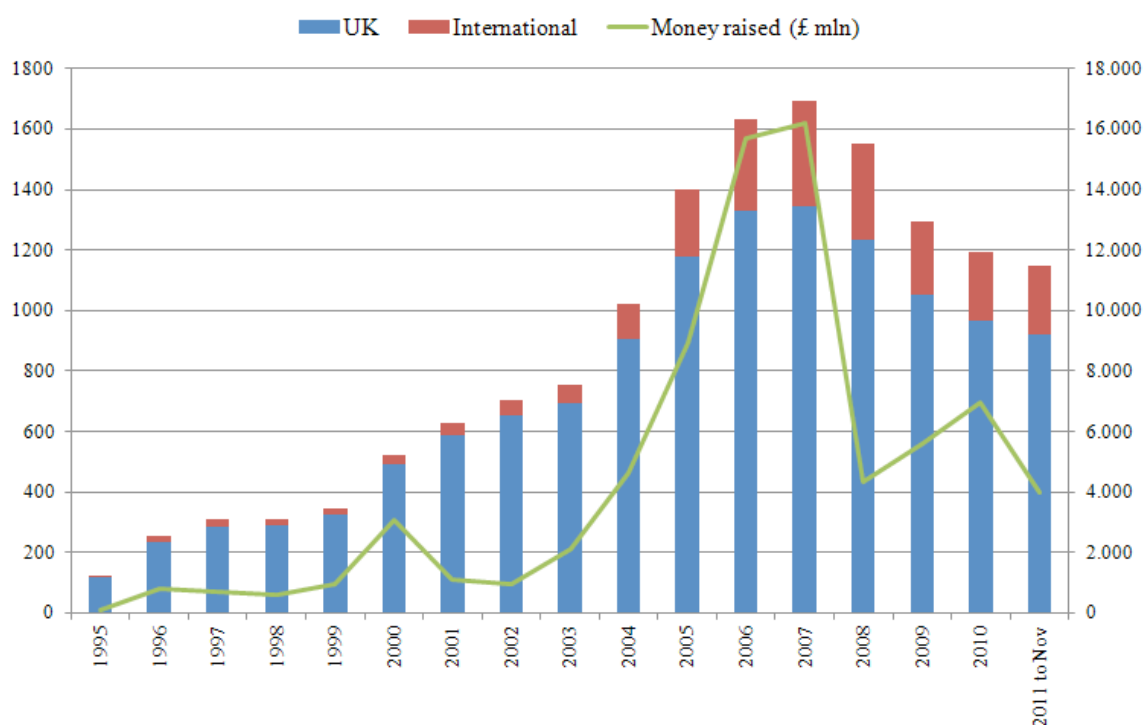


Overall, despite cross country differences, European SMEs are generally characterized by a significant share of short-term debt and a high reliance on bank debt; moreover, in some countries (as Italy, for example), a low level of capitalization and a shortage of both private equity and venture capital funds are relevant issues. Policy makers have tried to increase capitalization of SMEs and to facilitate their access to external funds through a number of initiatives, such as the launch of SME-dedicated stock markets, that are the focus of the next section.

3. Institutional settings for SMEs listing

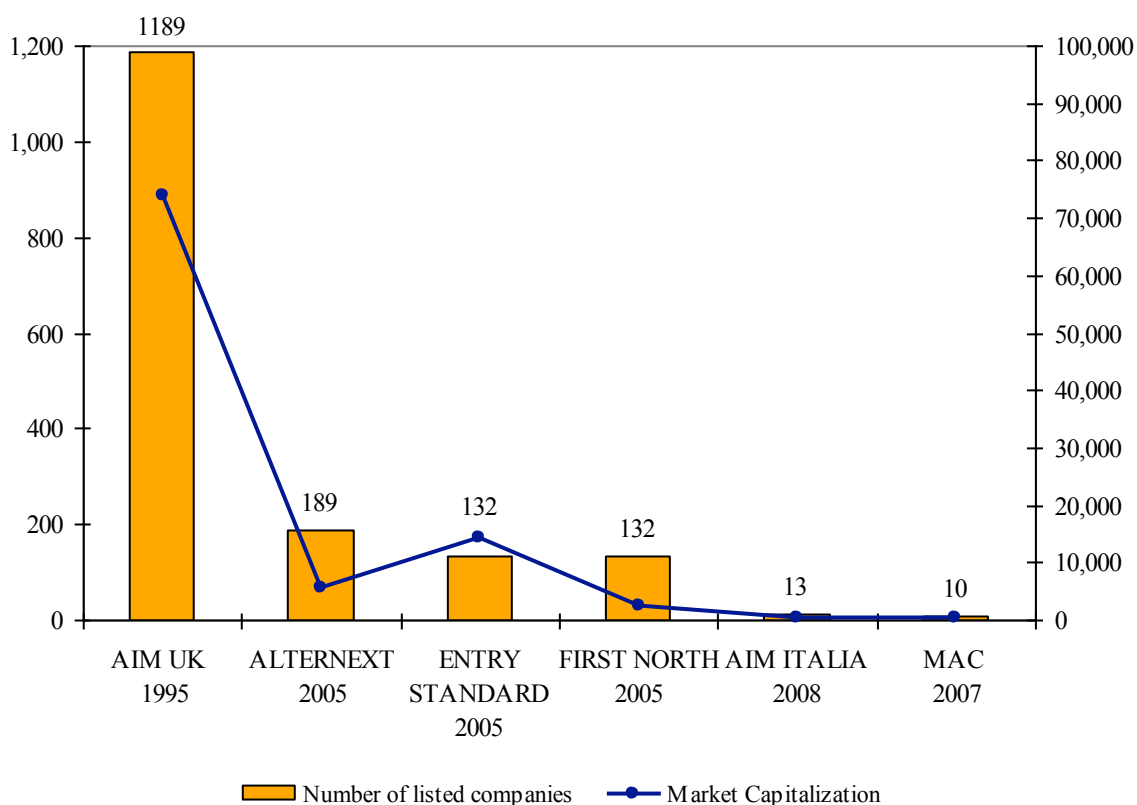
Increased competition in the new global arena and the need to reduce the dependence from the banking system call for a different capital structure of SMEs and for the design of proper incentives for SMEs to turn to capital

Figure 3: Number of companies listed on AIM UK, 1995-2011



AIM UK, with a total market capitalization of €74 bn; Alternext, First North, and Entry Standard are less developed, but still successful, with 189, 132, and 132 listed companies and a market capitalization of €5.5 bn, €14.1 bn, and €2.6 bn respectively; only 13 and 10 companies were listed on the AIM Italia and the MAC, with a market capitalization of €0,313 bn and €0,269 bn respectively ⁷. Many reasons can be taken into account to explain these figures: in particular, both higher admission fees and higher annual listing fees are likely to play an important role. For example, minimum fees for the AIM Italia are set at a significantly higher level with respect to those of the AIM London, Entry Standard and Alternext

Figure 4: Number of listed companies (left scale) and market capitalization of SMEs-dedicated stock markets (**right scale, mln €**)*



higher than €50 mln;⁸ lower thresholds are set for small and micro enterprises (Table 5); banks and financial firms, real estate companies and investment holding companies are excluded.

Table 5: European criteria for the identification of SMEs

	Number of employees	Annual balance sheet total	Annual turnover
		AND	OR
Medium			

Table 6: Sample of SMEs listed on MTA

		Number of employees, 2010	Total assets 2010, mln €	Turnover 2010, mln €	Sector
1	INDUSTRIA E INNOVAZIONE S.P.A.	12	135,2	6,0	Energy
2	BORGOSIESA S.P.A.	13	131,7		

Figure 5: Profitability, capitalization and liquidity of SMEs listed in Italian exchanges, 2010

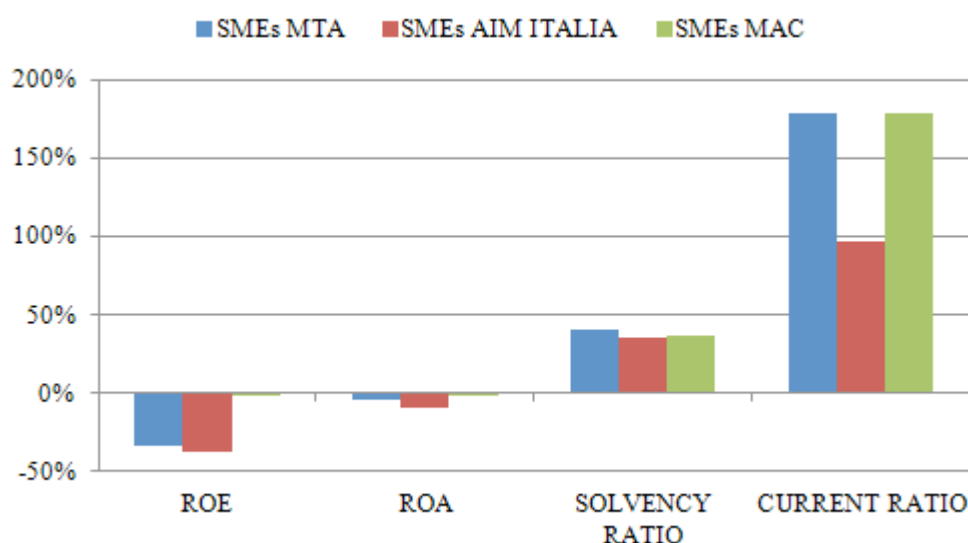
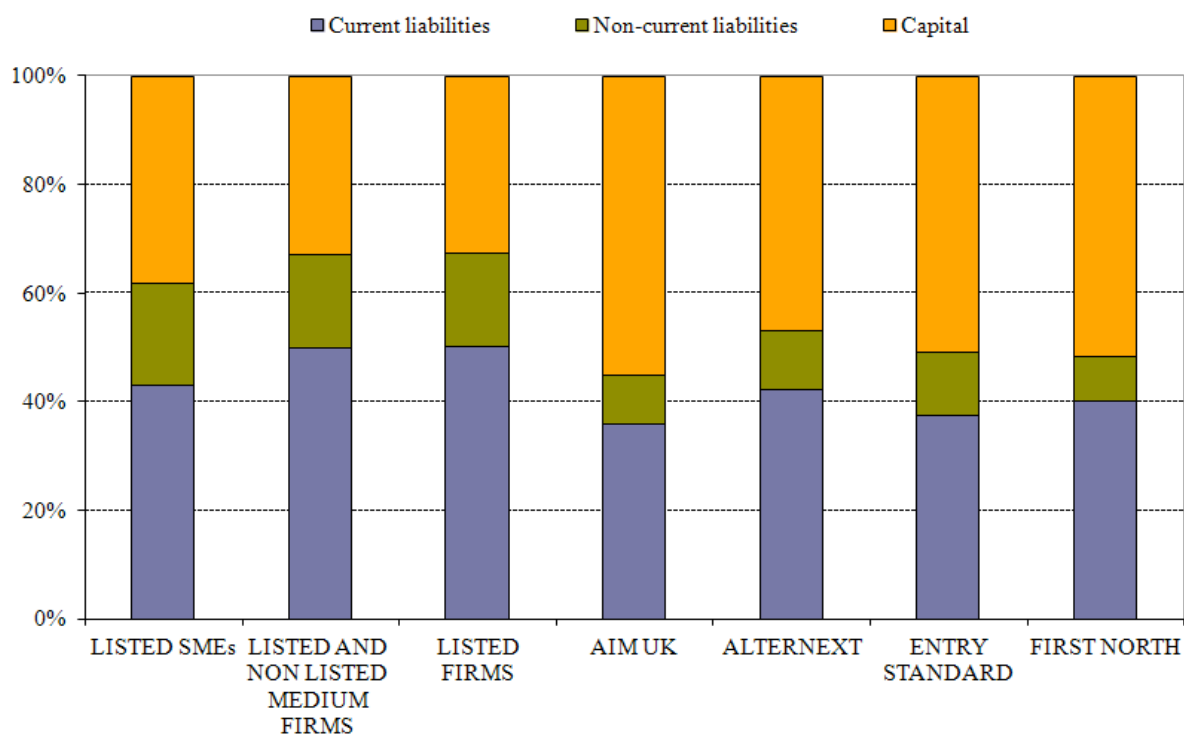


Figure 6: Liabilities structures of listed and not listed SMEs*, 2010



5. Institutional investors, private equity and venture capital in Italy

Institutional investors are the main vehicle by which households access financial markets. According to international standards, the portfolios of Italian households are characterized by a very small share of securities issued by institutional investors. Indeed, the percentage of investments in mutual funds, pension funds, and insurance securities is equal to 24%, compared with 47% in France, 46% in Germany, and 57% in UK (Banca d'Italia, 2010). Moreover, in Italy the weight of institutional investors in the stock market is much smaller than in other countries: in fact, the market capitalization held by institutional investors is equal to 28% in Italy, while it is 65% in USA and in Europe (EU-27), and 81% in UK (Mussari, 2011).

Given this situation, it is also important to highlight the lack of small cap funds. Indeed, in Italy only 9 funds are dedicated to investments in SMEs, versus 61 in France, and 57 in UK (Montanino, 2011). Furthermore, as we will show later, institutional investors generally consider as small cap those companies with a capitalization less than € 1 billion. This definition includes almost all companies listed in the Italian stock exchanges, revealing a weak propensity to invest in small and micro firms.

The weak role of institutional investors in the Italian stock market is perceived as a limit for all SMEs evaluating the option of going public: in fact, it is an obstacle to the placement of securities in the primary market and causes a reduction in trading activities in the secondary market, with negative effects on the liquidity of SME listed securities.

Another key issue is the lack of both venture capital (VC) and private equity (PE) markets. On the fundraising side, the Italian VC/PE market is dominated by generalist closed end funds (managed by asset management firms – Italian SGRs), followed by pan-European funds; banks play a limited role and the contribution of pension funds is very low, especially if compared with other European countries, where they are top players (EVCA, 2011, and Di Giorgio and Di Odoardo, 2008). After a quite significant growth from 1998 to 2008, the market suffered a retrenchment after the 2007-2008 financial crisis: in fact, in 2009 PE/VC investments halved from € 5,458 bn of the previous year to € 2,615 bn, falling again to € 2,461 bn in 2010. However, the early stage investments have known some growth since 2007, after a few years of very low figures from 2002 to 2006, reaching the amount of € 115 bn, € 98 bn, and € 89 bn in 2008, 2009, and 2010 respectively. Expansion investments have experienced a decreasing trend in recent years, as did buyout investments, which continue to account for the major share (around two-third) of total investments. Moreover, the percentage of investments in high tech firms was generally very low in the last decade (with a partial exception in 2000 and 2001), even though it recently jumped from 4% in 2007 and 2008 to 21% in 2009 and 37% in 2010; in 2010 the number of firms receiving VC/PE

funds was higher in the biotech (24%), medical (20%), media, entertainment (16%), and computer sectors (16%) (AIFI, 2011, and Di Giorgio and Di Odoardo 2008).

The limited availability of private equity and venture capital funds in Italy is often regarded as a relevant barrier to the growth of SMEs, which face significant financing obstacles especially in the start-up and the expansion phases: despite few good news, the traditionally low share of investments in early stages and in high-tech sectors is likely to have put a brake to growth, notably for more innovative firms¹². The cited European Commission survey on SMEs access to finance showed that only 4% of sampled Italian SMEs are confident about obtaining financing from equity investors or venture capital firms, vis-à-vis the 16% EU-27 average; the results of our questionnaire seem to confirm an excess of demand relative to the supply of private equity/venture capital funds. A more efficient private equity and venture capital market could be beneficial and effective in helping SME growth and innovation¹³, thus allowing SMEs to be less dependent on bank financing¹⁴.

Another possible interpretation is that the demand for venture capital/private equity funds is scarce because SMEs are reluctant to grow and to go public; some support to this intuition emerged from our questionnaire. However, little demand for VC/PE funds could also be caused by other factors, such as the relatively high costs (in terms of both money and time) of PE/VC funds or the concerns about the loss of control due to the involvement of PE/VC funds into firms.

6. The Questionnaire

In order to investigate the reasons of the relatively scarce presence of listed SMEs in Italy despite their prominent role in the economy, we chose to contact a sample of firms and institutional investors in order to receive direct information about:

- The decision of SMEs of going (or not going) public;

¹² For an overview of the VC/PE market in Italy until 2006 see Di Giorgio and Di Odoardo (2008).

¹³ However, it must be recalled that the literature has found mixed evidence on the causal link between a developed venture capital/private equity market on one side and innovation activity and growth on the other side: for example, according to Hellman and Puri (2000) and Kortum and Lerner (2000), in the United States venture capital plays a key role in promoting innovation and growth; but Ueda and Hirukawa (2008a) found that venture capital has at best a weak positive impact on innovation, while Gompers and Lerner (2001) indicated that the causal chain is the opposite, i.e. most innovative firms are those who go in search of venture capital funds, and similar results were obtained by Ueda and Hirukawa (2008b; “innovation first” hypothesis). With regard to Europe, Di Giorgio and Di Odoardo (2007) found a positive effect of venture capital investments on GDP growth in the period 1993-2004, while Bottazzi and Da Rin (2002) do not find higher growth and employment creation for listed firms funded by venture capital; similar conclusions are reached by Hamao, Packer and Ritter (1998) for Japan, who found that venture capital-backed IPOs in Japan do not perform better in the long run than other IPOs.

¹⁴ Berger and Udell (2011) show that there is an inverse association between the number of banking relationships and funding by venture capitalists, based on a dataset of venture capital funds obtained by SMEs and bank-firm relationships in Germany, Italy and the United Kingdom; besides, firms backed by venture capital before seeking bank funding are less likely to use bank financing.

- The choice of investors to allocate (or not) their funds on SMEs;
- The choice of firms over the preferred regulated market;
- The most relevant costs and benefits of being listed;
- The policy recommendations.

We submitted a questionnaire¹⁵ to our sample of both listed firms and institutional investors.

The questionnaire submitted to firms is divided into 6 Parts:

1. Obstacles and advantages of listing
2. Where to go public?
3. Before going public
4. After going public
5. Governance
6. Interventions to encourage the listing of SMEs

The questionnaire submitted to institutional investors include parts 1, 2, 6 and a part dedicating to investment in SMEs in Italy. Interviews were conducted either by telephone or face to face with senior managers. In few cases, the questionnaires were sent in excel format by email.

In this section, we present the results obtained from the questionnaires completed by the 5th of December 2011: in particular, 10 questionnaires from listed firms and 10 questionnaires from institutional investors. Due to the small number of completed questionnaires received so far, we decided not to perform any quantitative analysis; however, the results obtained so far seem to be sufficiently consistent to provide us with a reliable picture of the current situation. In the following subsections, we illustrate and discuss the results obtained from the questionnaire.

Part 1: Obstacles and advantages of listing

The first session of the questionnaire aims at analyzing the costs and benefits of listing. The decision of going public is complex and the relevant costs and benefits cannot be captured by a single theoretical model: Pagano et al. (1998) provided an overview of the main findings concerning the decision of going public¹⁶ and performed an empirical research on a sample of Italian firms, concluding that the probability of going public increases with both size and industry market-to-book ratio; they also found that the main reason for listing is the need of rebalancing

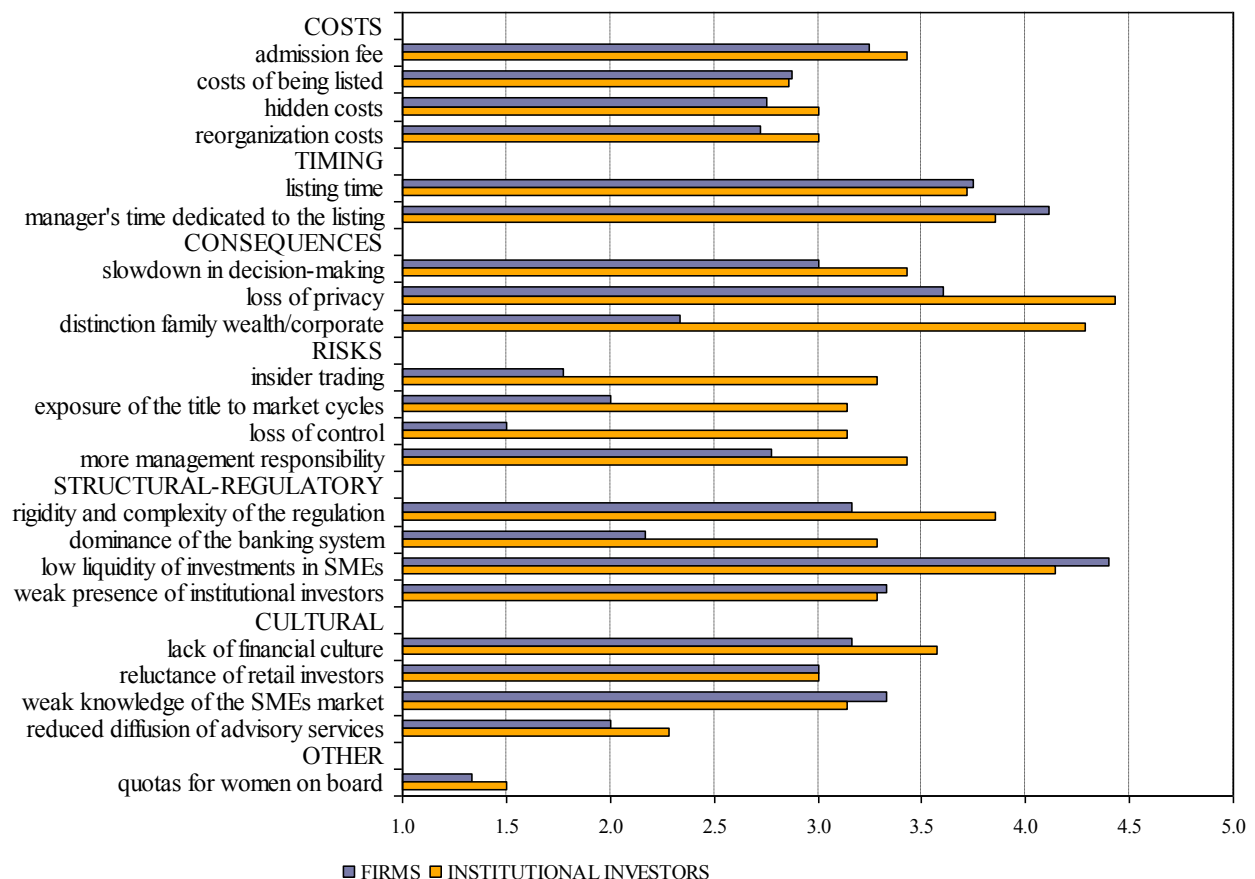
¹⁵ The questionnaire is in Italian and is available upon request.

¹⁶ Main theories on the costs of going public focus, among other factors, on the following: adverse selection and fixed costs (both lowering the probability of small firms going public), loss of confidentiality (lowering the likelihood of high-tech companies going public; Campbell 1979, Yosha 1995). Main theories on the benefits of going public are focused on: overcoming borrowing constraints, greater bargaining power with banks, liquidity and portfolio diversification, monitoring, enlargement of the set of potential investors, stock market monitoring, investor recognition, change of control, windows of opportunity.

financial sheets after large investments, rather than the need to fund new investments. Chemmanur and Fulghieri (1999) developed a theoretical model to understand at what stage of life a company should go public; Chemmanur et al. (2010) investigated the relationship between the decision of going public and market performance both before and after listing; Boot et al. (2006) focused on incentives, costs and benefits of being public versus those of staying private; Lerner (1994) studied the timing of IPOs of a sample of privately held venture-backed biotechnology firms, finding that these companies decide to go public when share prices are high, while they prefer to stay private when prices are low.

Many issues identified by theoretical contributions have been investigated through this section of the questionnaire, with a special focus on the Italian context. The interviewees had to rank costs and benefits on a 1 (non- relevant) to 5 (very relevant) scale. Figure 8 shows the results for both companies and institutional investors with respect to costs.

Figure 8: The costs of going public



Admission fees and other monetary costs are perceived as a relevant barrier to entry; however, the time consumed to fulfill listing requirements seems to be regarded as more burdensome. It is important to notice that monetary costs are more important for firms than for

institutional investors: this is probably due to a sample bias, given that interviews were conducted at companies that have already chosen to go public. Despite these considerations, listing fees (especially admission fees) are still regarded as relevant: it may be useful to recall that, according to Borsa Italiana, issuers listed on the MTA have to bear an average cost of € 800/900.000 (i.e., from 2% to 5% of the total amount of funds raised through the IPO), while issuers listed on the AIM Italia have to bear an average cost of € 200/300.000 (i.e., between 5% and 6% of the total amount of funds raised through the IPO, as shown by Mussari, 2011). It is worth pointing out that the fees to be paid on the AIM Italia are higher than those on other European SME-dedicated markets, as recalled in Section 3. Moreover, listed Italian firms incur non-monetary costs, such as the mandatory publication on newspapers of risk bulletins, that foreign listed firms do not incur.

Both the potential slowdown of decision-making procedures and the loss of privacy (for example, institutional investors stress the firms' reluctance to disclose their business plans) that may result from listing seem to matter for both firms and investors; the distinction between family and corporate wealth is regarded as a very important consequence of going public by institutional investors, but not by firms. Risks related to insider trading, exposure to market cycles, increased management responsibility and loss of control are perceived as very relevant by investors. Surprisingly, the potential loss of control does not seem to be a major concern for firms: however, this result might change with a larger sample, or could be interpreted as a firms' attempt to deny their desire to maintain the traditional structure of ownership and governance.

With regard to regulatory costs, stability emerges as the basic need from the responses of both firms and investors. Obviously, the dominant role of the banking system is viewed as a relevant obstacle to listing more by investors than by firms, while the limited role of institutional investors is regarded as an important structural weakness by both firms and investors themselves. The scarce liquidity of SME securities is considered as a major issue by both firms and market operators.

Among cultural obstacles, firms and investors agree on the importance of the lack of financial culture on the companies' side, the poor knowledge of the SME market and the reluctance of retail investors.

Figure 9: The benefits of going public

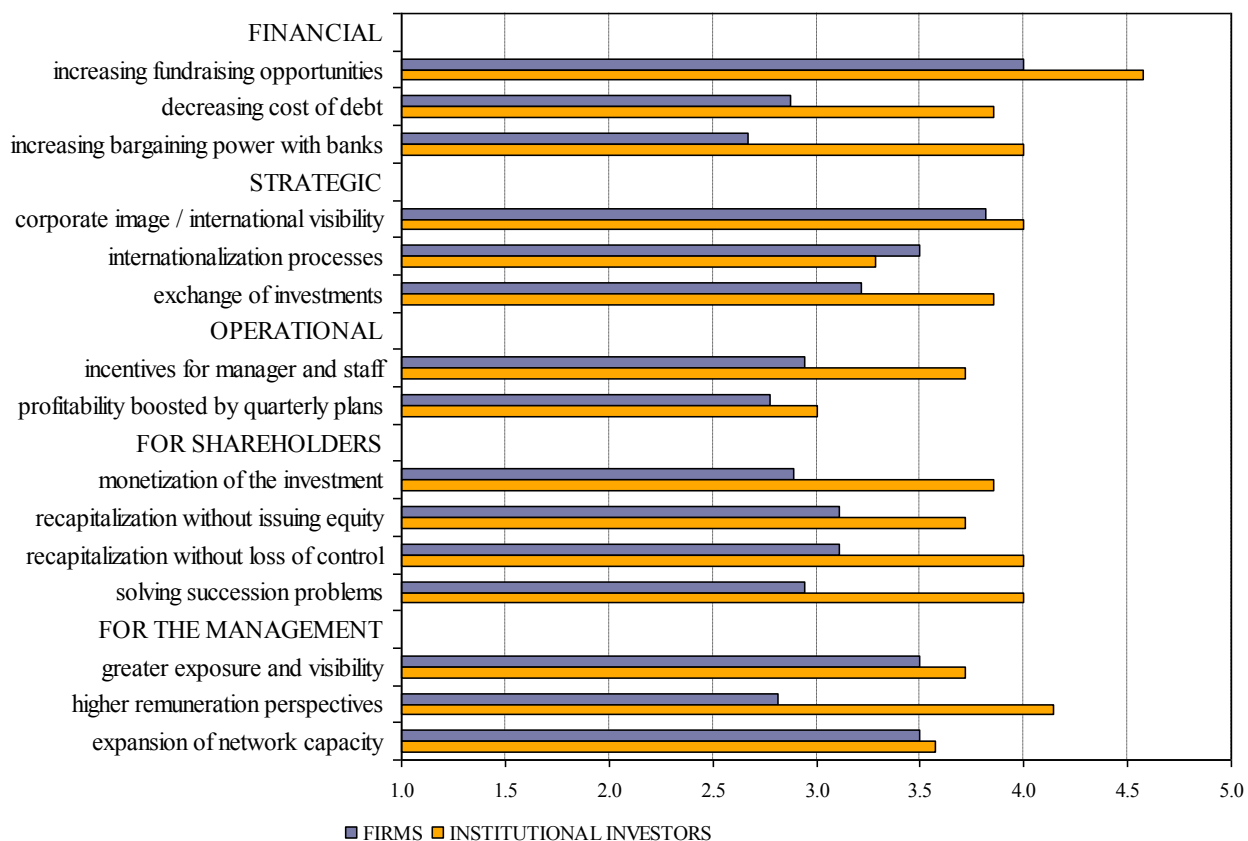
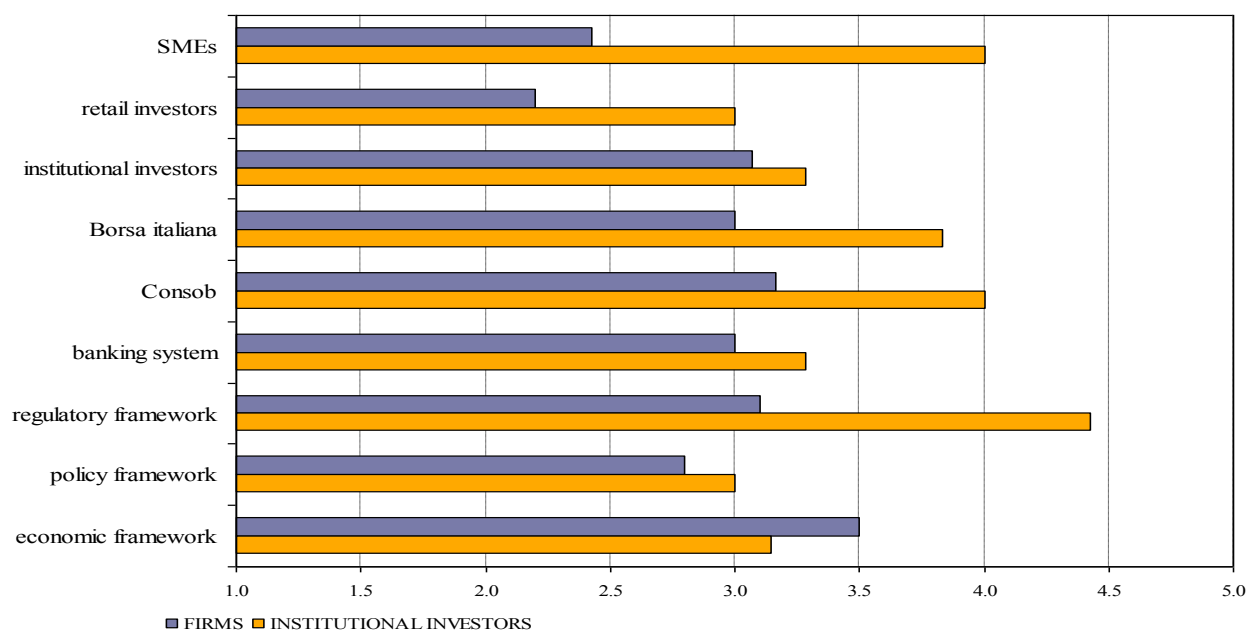


Figure 9 shows the responses of both firms and investors about the benefits of going public. Not surprisingly, the major advantage of listing is the access to an extra source of funds; firms also consider listing as an useful tool to increase their bargaining power with banks and obtain better lending conditions. As highlighted by Rajan (1992), gaining access to the stock market, thus disseminating information to a large population of investors, ensures both a lower cost of credit and a larger potential supply of external finance.

Strategic benefits from going public include corporate image and international visibility: in fact, investors, both foreign and domestic, can interpret being listed on a major regulated market as a quality signal. It is worth noticing that mandatory reporting procedures are perceived by listed companies as operational advantages: in fact, even if these procedures are expensive and burdensome (and imply the disclosure of corporate information to fiscal authorities and competitors), companies claim that they induce more efficient management processes.

The benefits of listing for shareholders (monetization, recapitalization, succession) and managers (remuneration, visibility, networking) are deemed relevant more by investors than by companies.

Figure 10: The scarce SMEs listing in Italian stock exchanges: who is responsible?



We have asked our respondents to provide their view about the current situation of Italian SME-dedicated markets: in particular, we asked them to identify responsibilities. Again, they had to rank responsibilities on a 1 (low responsibility) to 5 (high responsibility) scale. The results are presented in Figure 10 above.

Our intuition is that the low number of listed Italian SMEs is a rational response to the current economic and regulatory framework. However, while this intuition seem to be confirmed by the responses of institutional investors (who point out the responsibilities of the regulatory framework, together with those of Consob and Borsa Italiana), it is not supported by those of firms. Investors also claim that companies themselves are responsible, mainly because of their poor financial culture. In fact, most Italian SMEs are family-owned businesses, traditionally reluctant to give up total control: actually, the lack of dedicated institutional investors could itself be a consequence of this reluctance.

Part 2: Where to go public?

The choice of the regulated market on which being listed is a relatively new issue for companies: in fact, the possibility of choosing among different markets is a feature of the post-MiFID world (i.e., with the notable exception of the AIM London, European SME-dedicated markets have been set up after 2004).

This part of the questionnaire aims at investigating which market characteristics are more attractive to both companies and investors. The main outcome is that the choice of being listed on

the AIM Italia is driven by the fact that SMEs are not able to meet the requirements to access the MTA (i.e., either the capitalization requirement¹⁷ or the free floating requirement¹⁸). The MAC is never the preferred option. A possible explanation of this outcome is that companies are willing to signal their quality by complying with the highest level of disclosure and with the stricter and costlier set of rules (i.e., a sort of regulatory “race to the top”): in fact, quality signals may positively affect share prices, liquidity, and cost of funds. In this sense, the MAC seems to suffer from a negative bias that could be overcome through a merger with AIM Italia, as planned by Borsa Italiana and supported by the large majority of our sample.

Another interesting outcome is that investors are interested in small caps with a strong growth potential, but do not distinguish between companies listed on the MTA and those listed on the AIM Italia. Again, they tend to be reluctant to invest in companies listed on the MAC, thus confirming the existence of a negative bias.

Part 3: Before going public

Part 3 deals with listing procedures and requirements. In particular, it focuses on the determinants that are more likely to ensure the successful completion of the listing procedure.

The responses from our sample reveal that companies operating at international level are more likely to be successful. The quality of management is another determinant of success.

It is a widespread opinion in our sample that a major role in listing procedures is played by the financial advisors, the tax advisors, the independent auditors, the legal consultants, the sponsors, and finally the communication consultant.

Part 4: After going public

This set of questions focuses on the post-listing phase. Here, the main result is that the funds collected on the market have been employed to finance productive investments and innovation. Companies are fairly satisfied regarding the post-listing support offered by Borsa Italiana.

Finally, among the tools employed by listed companies to inform their current and potential investors, a strong preference goes to websites.

¹⁷ It is 40 millions Euros for the MTA.

¹⁸ It is 25% for MTA and 35% for the STAR segment.

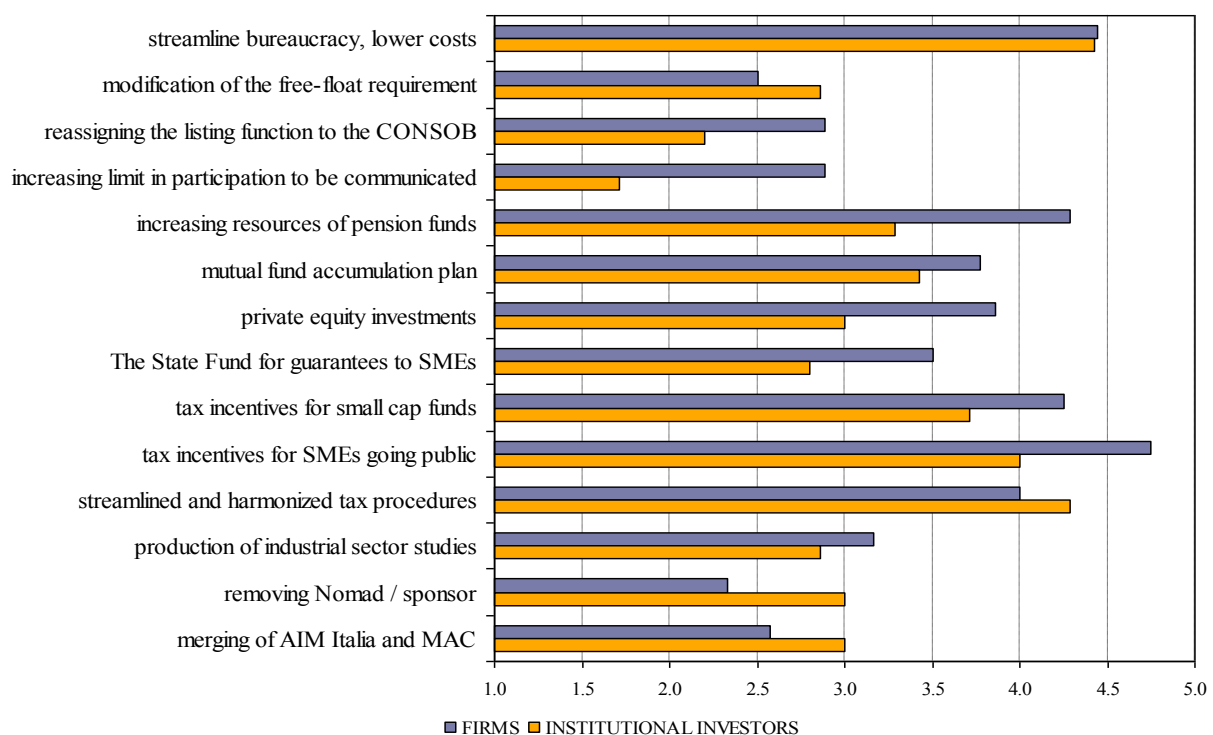
Part 5: Governance

Part 5 deals with corporate governance. It turns out that the post-listing board of directors is generally more efficient than the pre-listing one: our sample claims that this is due to the clear separation of governmental and business roles, to the higher quality of human resources, and to the presence of independent directors and specialized committees within the board.

Part 6: Interventions to encourage the listing of SMEs

This section investigates which policy interventions could be undertaken in order to support the listing of SMEs in Italy. As usual, companies and investors were asked to rank a broad selection of measures on a 1 (non-effective) to 5 (very effective) scale. Results for both companies and institutional investors are shown in Figure 11. The main result is that policies capable of ensuring stability in the regulatory environment and of favoring the capitalization of SMEs were the preferred ones.

Figure 11: Interventions to encourage the listing of SMEs



Tax incentives for listed SME and for small cap investment funds are supposed to be very effective by both firms and investors; in particular, the introduction of tax cuts for those investing in companies listed on the AIM Italia and/or the MAC is considered as a valuable option. The issue of fiscal incentives is intensely debated also with regard to the AIM UK (for example, a favorable tax

regime on capital gains has been proposed by Grant Thornton, 2010): their rationale is to address the negative bias suffered by SMEs versus large firms (i.e., the so called “equity gap”), due to asymmetric information, transaction costs, illiquidity of assets, and scarce trading of assets, further reinforced by the relatively higher costs of due diligence procedures. Fiscal incentives could fill the “equity gap” by supporting SMEs both in the primary and the secondary market, hence improving liquidity, reducing the cost of capital, and favoring fund raising.

Favorable capital gain or income tax treatments, together with dividend relief (for retail investors and/or venture capital funds), can offset the high risk that investors have to bear when they invest in SMEs. Moreover, favorable fiscal treatments could increase the amount of investments of private equity funds, small cap funds, and pension funds.

On the whole, a streamlining of regulatory and bureaucratic costs is highly desirable for both firms and investors; with regard to disclosure requirements, the 2% equity stake threshold for the compulsory communication to the market is also perceived as burdensome. Finally, a merger between the AIM Italia and the MAC is generally supported, even though firms do not see it as a key intervention.

The large majority of our sample believes that the new Basel III framework will increase the costs of funds for SMEs. In this scenario, it becomes even more relevant to adopt policy measures capable of favoring the listing of SMEs.

Part 7: Investments in SMEs

This part of the questionnaire was submitted to institutional investors only. It deals with the choice of investing in stocks with a relatively small market capitalization. The institutional investors who completed the questionnaire are not constrained to invest a share of their portfolio in SME securities; moreover, they do not manage SME dedicated funds.

The answers received show that investors are only interested in returns; actually, they also value the possibility of having an easy access to the top management. Investors are not interested in corporate governance; furthermore, they do not perceive fiscal incentives and visibility as relevant benefits.

Investors think that the main reasons that prevent investments in Italian SMEs are the following:

- SME’s access to regulated markets is often seen as the culmination of a process of growth and not as a starting point; indeed Pagano et al. (1998) show that in Italy IPOs tend to involve companies that were very profitable in the previous years;

- The market capitalization of the high-growth sectors is very low in Italy; as shown in Table 9, there are only 20 Hi-Tech companies listed on the MTA and they account for the 0.3% of total market capitalization; companies operating in high-value-added sectors, such as basic materials, and media and telecommunications, account just for the 0.1%, 1.4%, and 4.7% of total market capitalization respectively (and they are often publicly owned);
- The market capitalization of all listed Italian companies is very low if compared with international standards; in fact, the average capitalization is € 1.250 millions and the median is only € 81 million; moreover, 77% (85%) of the companies have a market capitalization lower than € 500 million (€ 1 billion), meaning that almost all the companies in the Italian stock exchanges can be considered as small cap companies.

Table 9: Capitalization of Italian Companies (November 30, 2011)

Borsa Italia: Capitalization of Italian Companies (November 30, 2011)			
Sectors	Number of companies	Capitalization millions of €	% total
Automobiles & Parts	10	9,889.8	3.0%
Banks	19	55,608.4	16.7%
Basic Materials	2	178.6	0.1%
Chemicals	3	430.5	0.1%
Construction & materials	15	5,234.1	1.6%
Financial Services	22	7,641.6	2.3%
Food	10	6,012.9	1.8%
Health Care	7	3,797.2	1.1%
Industrial Goods & Services	46	28,999.1	8.7%
Insurance	8	23,660.5	7.1%
Media	15	4,806.4	1.4%
Oil & Gas	7	79,064.3	23.8%
Personal & Household Goods	29	17,872.5	5.4%
Public Services	18	65,366.0	19.6%
Real estate	10	1,182.3	0.4%
Retail	5	1,059.6	0.3%
Technology	20	1,159.6	0.3%
Telecommunications	4	15,713.3	4.7%
Travel & Leisure	9	4,431.1	1.3%
Total MTA	259	332,107.8	99.8%
AIM	13	313.4	0.094%
MAC	10	269.0	0.081%
Total MTA - AIM - MAC	282	332,690.2	100%

7. Recent initiatives to support Italian SMEs

A number of significant initiatives have been adopted in Italy to support SME growth, internationalization, capitalization, and access to loans. In June 2011, ABI and Borsa Italiana reached an agreement on an “IPO Bank Facility”, designed to grant credit to newly listed firms, especially SMEs. Banks participating the program will provide firms with medium-long term funds

to be allocated on growth-enhancing investments (i.e., physical or financial investments, not substituting a previous debt); the amount of funding will be determined applying a 1 to 2 multiplier to the total resources raised through the IPO. Companies obtaining loans will have to maintain a balanced post-IPO financial structure and banks will allow a fast track procedure for the loans, having also the possibility to use the information provided by firms to Borsa Italiana (for admission to listing). The estimated extra amount of loans made available to firms by the banking industry in the first three years is €1 bn (ABI and Borsa Italiana, 2011).

Three more projects have been launched in October 2011:

1. Elite, a three-year training program created through the cooperation of Borsa Italiana and the Italian Ministry of Economy and Finance with the aim of promoting the organizational development, transparency and efficient management of SMEs; Elite is not a market but rather a program designed to enhance SMEs growth regardless of listing. Access to the network of players around the stock market, proximity to listed companies, increased ability to attract capital and strengthened reputation are all benefits offered by Elite. Eligibility criteria include a growth project, a minimum turnover of € 10 million (and growing; or lower, but only with high growth rates); operative result must be higher than 5% and last income statement must report a profit. The training program includes the budget and business plan elaboration, half-year financial reporting, definition of an adequate governance model and auditing of financial accounts; the program ends with a final check up and the release of a quality certificate;
2. The European Investment Fund-Italian Investment Fund (EIF-FII)¹⁹ program, aimed at making parallel co-investments to promote the capitalization and growth of SMEs in the segment of funds for growth, with an initial total amount of €200 mln (50% by EIF and 50% by FII), renewable after the first 4 years period. The FII will be entrusted with the task of finding possible options for the co-investments: the ultimate objective is to increase the financial resources available for growth to Italian SMEs; the governance of investment funds that will receive the resources is also expected to be strengthened and be thus able to attract further investments;

¹⁹ The European Investment Fund is part of the European Investment Bank (EIB) Group and is specialist provider of small and medium-sized enterprises risk finance across Europe. The Italian Investment Fund (Fondo Italiano d'Investimento) is a fund established in March 2010 by the Italian Ministry of Economy and Finance, several sponsor banks and category associations, with the objective of supporting SMEs growth through investments in their capital.

3. Sace²⁰ will support SMEs through a strategy of acquisition and management of qualified investments (not exceeding 4%) in export-oriented companies listed or about to being listed, with no minimum capitalization threshold; an asset manager specialized in Small Cap will invest with a 3 to 5 years time horizon, and at least 60% of the portfolio will be dedicated to listed companies.

Moreover, the introduction of a favorable weighting for bank exposures toward SMEs under the Basel III framework and the new EU Capital Requirements Directive (the so-called CRD IV) has been advocated by ABI, Confindustria, Rete Imprese Italia and Alleanza delle Cooperative Italiane, and proposed to the European Commission: such proposal envisages that a particular coefficient (SME Supporting Factor) should be applied when calculating RWA related to exposures toward SMEs, in order to leave the Basel II 8% capital requirement unchanged. This proposal might be helpful in order to avoid a credit crunch for SMEs, which could be a serious and undesirable collateral effect of the higher capital requirements mandated by Basel III. The European Banking Authority (EBA) has been assigned the task of preparing by September 2012 a study on the risks posed by SMEs and, based on the results of the study, the EU Commission might subsequently amend its CRD IV proposal.

8. Policy Implications

The interventions to support SMEs described in the previous section seem to go in the right direction; however, further policy interventions are necessary. In fact, the institutional framework has favored undercapitalization and has made bank loans the only effective source of funds.

The newly established SME-dedicated markets, AIM Italia and MAC, have not been successful so far, despite convenient listing procedures. The lack of liquidity of the securities traded on the SME-dedicated markets together with the low profitability of listed firms have made these markets not attractive for investors, thus further discouraging SMEs from being listed on these markets. Therefore, policy interventions should aim at raising the listing requirements in order to signal the good quality of listed firms to potential investors; moreover, merging AIM Italia and MAC could be useful to enlarge the size of the market and increase liquidity.

Favorable conditions in terms of costs and procedures could be envisaged for companies operating in high value added sectors, in order to facilitate and encourage their listing, for example:

²⁰ SACE (Servizi Assicurativi del Commercio Estero) is an Italian insurance and financial group founded in 1977 and active in export credit, credit insurance, investment protection, financial guarantees, sureties and factoring; it is fully owned by the Italian Ministry of Economy and Finance and works with SMEs and large corporations in over 180 countries, supporting export and internationalization.

1. Tailored admission requirements and adequate listing fees, together with fiscal incentives for investors, should be introduced, so as to promote the access to regulated markets of high-tech companies;
2. Dedicated incentives should be designed to favor venture capital and private equity investing in start-up companies;
3. Enhanced reimbursement flexibility for investments in SMEs operating in selected industries should be considered in order to solve liquidity issues of closed-ends funds.

Obviously, the structural undercapitalization of Italian listed SMEs with respect to SMEs listed in foreign markets raises a confidence issue on the side of investors: so, it is desirable to change the financial structure of SMEs, possibly decreasing the cost of debt and increasing the willingness of investing into small/young/innovative and thus potentially riskier companies.

Moreover, from the standpoint of SMEs, both fiscal incentives and the reduction of bureaucratic and regulatory costs seem to be crucial to favor the decision of entering regulated markets, as it is clear from the responses to our questionnaire: in fact, these are the only possible solutions to overcome all those cultural factors (especially binding in family-run enterprises) that make bank loans the preferred source of funds. On the first issue, incentives should be in place to encourage firms to achieve more diversification in their sources of funding (in this perspective, a strengthening of the PE/VC market would be crucial), along with a stronger capitalization. Actually, the recent ABI-Borsa Italiana “IPO Bank Facility” appears to be an effective move in this direction.

9. Concluding remarks

It is well known that the size of Italian firms is small if compared with the size of firms operating in other industrialized countries. This study confirms the intuition that the Italian economic system does not provide firms with the right incentives to grow: more precisely, this study suggests that Italian entrepreneurs keep their firms small in order to rationally respond to a set of distortive incentives provided by legislation (for example, about labor market and unions), regulation (for example, about accounting standards and tax procedures), and industrial policies.²¹

It is worth noticing that the results derived from the questionnaire submitted to a sample of listed firms and institutional investors are preliminary as only a small fraction of the sample completed and returned the questionnaire. However, some of the findings seem to be robust:

²¹ See Di Giorgio and Parascandolo (2010).

1. Both the firms and the institutional investors recognize the importance of being listed on regulated markets to favor investments and to improve international visibility; however, both recognize that listing is costly;
2. Institutional investors think that the major obstacles to the access of SMEs to regulated markets are:
 - i. The fear of entrepreneurs of losing total control over firms;
 - ii. The willingness of entrepreneurs of retaining informal managerial practices;
 - iii. The lack of financial literacy;
 - iv. Both the firms and the institutional investors think that there is no need of having many SME-dedicated markets;
3. Both the firms and the institutional investors claim that the Italian economic system lacks stability in terms of regulation, thus making long term strategies difficult to be implemented.

These results implicitly suggest a set of solutions to favor the access of Italian SMEs to regulated markets.

Some technical interventions may be designed to promote the start-up of SME-dedicated investment funds and to make SME-dedicated markets more liquid. However, what seems to be the most difficult issue to address is the lack of Italian SMEs operating in industrial sectors which are attractive for investors (for example, hi-tech and energy sectors): in fact, a complete and appropriate set of industrial policies should be implemented in order to develop capital intensive sectors.

As for future research, this study could be extended across two dimensions: first, the size of the sample should be enlarged in order to increase robustness of the results and to support the main findings through more sophisticated quantitative analysis; second, the questionnaire could be rolled out for a longer time span in order to identify the existence of medium-long term factors having an impact on the perceived costs and benefits from listing.

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