

Financing innovation in small businesses and start-up firms: policy issues

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Structure course

- **Introduction**
- **The nature and financing of innovative enterprises**
- **From ideas to start-ups: the role of public initiatives**
- **Business angels and early-stage financing**
- **Early-stage growth: venture capital and other financial intermediaries**
- **Financial development and public financial markets**
- **Design, implementation and evaluation of early-stage policies**
- **Recapitulation and conclusions**

Module 5

Financial Development and Public Capital Markets

Module objectives

- **Understanding stock markets**
 - **Role in innovation finance process**
 - **Terminology and regulatory framework**
 - **The levers of the VC investment process**
- **The major “junior” exchanges**
- **The nature and role of trade sales**

Exit markets

- Importance of suitable **public markets** for the development of VC industry.
- **Europe is lacking:** market fragmentation and absence of large platforms for exit.
- Small-scale attempts to cater for the requirements of growth companies.

The role of stock markets

- **Provide liquidity to private investors**
- **Exert a pull effect on venture capital activity**
 - **Lucrative exits entice investors**
 - **Lucrative exits excite potential entrepreneurs**
- **Impose financial discipline and transparency**
 - **Put weight on accurate financial performance data**
 - **Provide pricing / valuation parameters**

Important aspects of stock markets

- **Initial public offering**

- Issue of new stock by once private company
- Used to raise growth or expansion capital

- **Secondary market (trading of existing stocks)**

- Needs sufficient trading liquidity
- Price instability due to low liquidity deters investors
- Low liquidity results from insufficient scale of stock exchange or limited number of investors

Relevant stock market regulations

- **Listing requirements**
 - **Operational: earnings, working capital, audit history**
 - **Offering: size, public float**
- **Registration with overseeing commission**
- **Trading restrictions (for officers and directors)**
 - **Hold period**
 - **Escrow requirements**
- **Disclosure requirements (nature and frequency)**
- **Overall legal foundation for investor control**

Implications for innovative enterprises

- **Strict regulations can**
 - **Stifle young, less established companies**
 - **Discourage private investors**
 - **Turn away institutional investors**
- **Regulatory reform can be used to**
 - **Attune the exchange to the needs to younger, high-growth companies**
 - **Increase the exchange's appeal to institutional and international investors**

NASDAQ, OMX

- **The underpinning of the US VC industry**
 - **Most successful secondary market in OECD.**
 - **Has outpaced all other US markets in IPOs**
- **In May 2007, NASDAQ merged with OMX, the Scandinavian Exchange.**
- **Today's largest exchange company**
 - **Spanning 6 continents**
 - **Over 3,900 listed companies representing \$5.5 trillion in total market value**

Alternative Investment Market (AIM)

- **London Stock Exchange's international market for smaller growing companies.**
- **Since 1995, some 2,300 British and 400 foreign companies have raised a total of £49bn.**
- **1,550 companies, total cap £37.7bn (2008)**

NYSE Alternext

- **Established by Euronext in 2005 to meet the needs of small and mid-sized companies**
 - **Simplified access to the stock market**
 - **Streamlined listing requirements and trading rules.**
- **Locations in Paris, Amsterdam, Brussels, and Lisbon.**
- **128 companies, total cap €3.25bn (end 2008)**

Deutsche Börse's Entry Standard

- **Introduced in 2005 as a capital market for small and medium size companies offering**
 - **Reduced regulation**
 - **Limited transparency requirements**
- **115 companies, total cap. €0.74bn (2008)**

International dimensions

- **Increasing international focus in order to**
 - **Broaden investor base**
 - **Achieve higher trading liquidity**
- **Dissipation of “home bias” for listing companies**
 - **Based on rapid internationalization**
 - **Opportunities afforded by EEA integration**

Promotion of cross-border exits

- **Facilitation of information exchange**
 - **Build awareness of the capital market possibilities offered by the junior exchanges.**
 - **Institutional investors (to increase trading liquidity)**
 - **Entrepreneurs (to increase the number of listings)**
- **Training of support service providers**
 - **Stock analysis, consultants, and gatekeepers**
 - **Develop and disseminate specialized knowledge of the needs, regulations, and opportunities for small and medium enterprises.**

Market size in Europe

- **International aspects of entrepreneurial activity and finance**
- **EU Commission initiatives to remove obstacles to cross-border investments by VC fund**

Factors affecting trade sales

● Motivation

- Strategy for enhanced competitiveness
- Allows preemption of “new economic order”
- Important intelligence mechanism

● Opportunity

- Supply of high-quality innovative enterprises
- Active and internationally oriented investment banking and consulting community
- Development of stock markets
- Well developed bond markets or project lending