ORIGINAL SCIENTIFIC PAPER

SME STOCK EXCHANGES - SHOULD THEY HAVE A GREATER ROLE?

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ABSTRACT Access to finance is widely recognized as one of the main impediments for growth and development of the small and medium enterprises. This article presents certain aspects of development of stock exchanges oriented towards small and medium-size enterprises. It aims to contribute towards the growing debate on funding of small and medium enterprises through dedicated stock exchanges and serve as a useful contribution to stakeholders to undertake certain steps toward implementation of effective policies for design of exchanges dedicated to financing of small and medium enterprises.

KEY WORDS: *Small and medium enterprises, stock exchanges, SME exchanges, alternative markets, multilateral trade facilities (MTFs), Zagreb Stock Exchange*

JEL: D53, G15, P34

1. INTRODUCTION

One of the obstacles to growth and development of SME sector[1], especially pronounced in recent years, has been lack of access to external funding sources. Arguments can be found in large number of empirical studies. One of the prominent example is regular annual survey conducted by the joint efforts of European Commission (EC) and

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[1] There is no universal definition of what constitutes an SME. Definition of the SME varies across the countries but it is most often related to a certain number of employees, assets size and turnover. The current EU definition of SMEs was adopted on 6 May 2003 and came into force on 1 January 2005 (Recommendation 2003/361/EC). SMEs were defined as companies with less than 250 employees and a turnover not exceeding EUR 50 million or annual balance sheet not exceeding EUR 43 million. In terms of market capitalization, at a worldwide level, there is no harmonized definition for large-cap, mid-cap, small-cap and micro-cap and the definitions vary from one geographical region to another. World Federation of Exchanges use following definition: large-cap (market cap > USD 1.3 billion), mid-cap (USD 1.3 billion > market cap > USD 200 million), small-cap (USD 200 million > market cap > USD 65 million), micro-cap (market cap < USD 65 million). Federation of European Securities Exchanges (FESE) use different thresholds. For micro, small and mid-cap market cap thresholds are EUR 50 million, EUR 250 million and EUR 750 million respectively.

European Central Bank (ECB).[2] International Finance Corporation (IFC) data show the financing shortfall for the 25-30 million formal SMEs in emerging countries at around $1 trillion.[3] The limited access of SME to external finance is thoroughly argued in report of Dalberg Global Development Advisors (2011). The financing challenge for SMEs is widely recognized by academic authors as well. Beck & Demirguc-Kunt (2006) found that there are substantial evidence that small firms face larger growth constraints and have less access to formal sources of external finance, potentially explaining the lack of SMEs' contribution to growth. Infelise (2014) mapped the initiatives to support access to finance for small-and medium-sized enterprises that were available at national level in 2012 in the five biggest European economies (Germany, France, the UK, Italy and Spain). They concluded that public subsidization of bank loans has been by far the most diffused type of intervention even though it fails to address long-term sustainability issues via a more diversified set of financing tools.

A number of contributors specifically discussed access to finance through public capital market, i.e. stock exchange. Arce, Lopez, & Sanjuan (2011) investigated and discussed four key issues surrounding the funding of newly created companies and those with high growth potential through market and other external sources other than bank loans, and presented certain measures and incentives: how to ensure a sufficiently wide investor base, how to overcome possible barriers which hinder companies accessing the market, the design of markets for small and medium capitalization securities and the role of regulation. Cumming & Johan (2011) examined how reduced listing standards regarding reporting requirements for companies have worked in the most developed markets in the world, the U.S, the U.K and Canada. Authors note that while more onerous exchange standards may prove too resource intensive for some fund-worthy companies to meet, they give market participants a signal of the quality of the exchange and the nature of the companies trading on the exchange. They suggest that lowering disclosure requirements and exchange listing standards are likely to be associated with increases in the extent and type of observed fraud. Grose & Friedman (2006) took legal and regulatory standpoint. They investigated different legal and regulatory approaches for improving access to finance and measures that can be used by traditional stock exchanges to attract smaller enterprises and gave certain recommendations for a simpler legal and regulatory framework for promoting access to primary equity markets - via both the traditional exchange, as well as using other alternatives.

This paper is structured as follows. Chapter 2 presents general characteristics and significance of the SME stock exchanges. Chapter 3 gives an overview of certain practi-

[2] According to Survey on the Access to Finance of Small and Medium-sized Enterprises (SAFE) from December 2015 conducted by European Commission (EC) and the European Central Bank (ECB), access to finance is most pressing problem to 10% of SMEs in the EU28. According to enterprise characteristics, access to finance is most pressing as a problem to gazelles (high-growth young enterprises), consistent with fact that the proportion of SMEs that have issued equity is highest among gazelles (European Commission, Survey on the access to finance of enterprises, Analytical Report 2015).

[3] According to IFC Enterprise Finance Gap Database (cited in Harwood, A., Konidaris, T., SME Exchanges in Emerging Market Economies, A Stocktaking of Development Practices, World Bank Group Policy Research Working Paper 7160, January 2015)

cal policies toward improving growth of SME exchanges. Chapter 4 discuss perspectives of Zagreb Stock Exchange (ZSE) in designing functional SME dedicated exchange. Last chapter is the conclusion.

2. GENERAL CHARACTERISTICS AND SIGNIFICANCE OF THE SME STOCK EXCHANGES

Majority of SME balance sheets typically heavily rely on long-term and short-term banking loans and other forms of debt financing.[4] In fact, SMEs prefer debt financing over equity financing.[5] However, this makes them especially vulnerable during times of economic crises and financial meltdown as evidenced by recent global crisis. Commercial banks significantly refrained from giving or extending loans to enterprises which seriously affected small and medium enterprises. In order to diminish such negative impact when availability of external debt sources for SMEs dries up, other forms of external *equity sources* have come into focus and closer attention of policymakers and other stakeholders on both sides of Atlantic. Although nowadays exists a variety of equity sources for SME (informal forms such as family, friends, business angels, and more formal forms such as venture capital funding & private equity funds, crowd funding) financing via public stock exchanges emerged as a saving solution, at least in EU countries. This came as no surprise as raising funds via stock exchanges represent one of the most prominent and promising source of external long-term equity financing. Equity financing gives stability and resistance to balance sheets in case of external financing shocks.

The majority of the prime stock market operators today increasingly target SME sector by developing specific platforms under the legislative framework of the multilateral trade facilities with lesser admission requirements than regulated market. Generally known as a SME-focused stock exchanges[6], they have recently arisen as valuable option for SME fundraising in their lifecycle.

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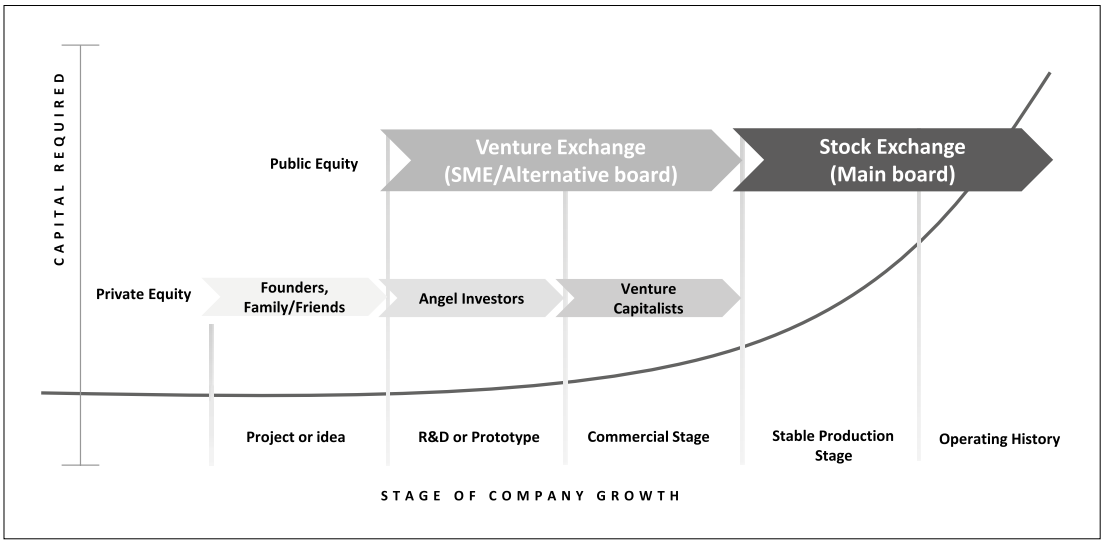
[4] For variety of reasons, debt finance is seen as unsuitable at seed and early stage of firm. Outlined by Durvy (2006), there are (for young technological firms) three main reasons: the lack of collateral and the uncertain prospects; borrowing is inappropriate because principal and interests payments would limit the cash flow flexibility of an expanding company at crucial times; the usual information asymmetries between entrepreneurs and a bank are more pronounced because of the skills needed to evaluate the activities.

[5] European Commission, Survey on the Access to Finance of Small and Medium-sized Enterprises (SAFE), December 2015., p. 8.

[6] Generally recognized as SME exchanges, they are also known under other terms such are the alternative markets, venture exchanges, growth markets, new markets, SME boards, venues for SME listings, second-tier markets, lower-tier markets, junior market segments, etc. Quite commonly, these markets are usually managed by the market operator in line with „regular" (main board) exchange. Although called SME exchanges, they usually represent different boards, market tiers or separate trading platform with distinctive trading rules, and listing & admission criteria compared to the main board. Major operators of regulated stock markets developed specific platforms targeting SMEs under the legislative framework of the multilateral trade facility (MTF).

Figure 1. Financing growth companies via venture exchange



Source: Adapted from TMX Group Limited (2013).

They have been established with the purpose of enabling SMEs to obtain public equity capital. The main feature of such venues is that listing requirements have been relaxed which in turn, may bring lower issuance costs for SMEs.[7] But in contrast to large enterprises, SMEs frequently encounter certain difficulties in raising funds via stock exchange. Generally, it involves high transaction costs, listing requirements and often very complex legal and regulatory frameworks. SMEs faced greater difficulties and costs to raise capital from equity markets than larger issues due to the lack of visibility of SME markets, the lack of market liquidity for SME shares and the high costs of an initial public offering (Baker & McKenzie 2012).

Nonetheless, SME dedicated exchange venues are increasingly gaining in popularity among renowned stock exchange operators. More prominent examples include NewConnect (Warsaw Stock Exchange), EnterNext and Alternext (Euronext), AIM (London Stock Exchange), AIM Italia - Mercato Alternativo del Capitale (Borsa Italiana), First North (NASDAQ OMX), Entry Standard (Deutsche Börse) in Europe, and TSX Venture Exchange (Toronto Stock Exchange), Mothers[8] (Tokio Stock Exchange), NASDAQ (in USA), BSE and NSE boards for SME (in India), SME Board (Shenzen Stock Exchange) overseas.[9]

Primordial SME stock exchange specifically designed for SMEs was UK Alternative Investment Market (AIM) created in 1995. Other forms of alternative trading venues

7 Usually, offering value determines the relative cost of the funding via stock exchange.

8 Acronym for *Market of the high-growth and emerging stocks*.

9 For detailed list of markets serving SMEs see Grant Thorton (2008).

followed, such as Dritter Markt in 2002, Entry Standard, Alternext and First North Alternative Market in 2005. Today, majority of such trading venues in EU are organized as MTFs.[10]

Pulling together key characteristics from several successful SME markets, in following table we summarize common distinctive features of SME board versus main market.

Table 1. Key differences between SME board and main market

SME board	Main market
Less extensive rulebook; usually regulated under rules of market operator, i.e. self-regulated	Strictly regulated by national securities (capital market) laws (and in EU relevant MiFID directives)
Publication of *information memorandum* (simpler than prospectus)	Obligatory publication of *prospectus*
Mandatory partners usually required (listing sponsor, certified adviser, market maker/liquidity provider)	Obligatory participation of investment company; on certain markets involvement of other agents and sponsors may be mandatory
Simpler and faster admission procedure and listing requirements; reduced administrative and procedural burden	More restrictive admission requirements and higher administrative and procedural burden
Less strict information requirements	Stricter information requirements
Lenient reporting requirements	Stricter ongoing reporting requirements
Shorter financial history and lower accounting standards	Longer financial history and higher accounting standards
Sometimes government tax incentives & other subsidies	Generally no government incentives
Smaller investor base with institutional and retail investors (on certain markets retail investors prevail)	Broad investor base, suited for regulated institutional investors such as pension funds, insurance companies, and other types of collective investment schemes
Perceived higher investment and liquidity risk	Perceived lower investment and liquidity risk
Aimed at potentially high-growth companies in the start-up or early stage (short track record), seeking to raise relatively smaller amounts (from few hundred thousands to a few millions euros)	Aimed at companies at an advanced stages of development, seeking to raise higher amounts of capital (from few million up to a few billion euros)
Firms operating in innovative sectors, mainly with intangible assets (e.g., IT, electronic media, telecommunication, biotechnology, environmental protection, alternative energy, etc.), although some markets attract broader set of companies from different sectors	Firms operating in various sectors

Sources: Author.

In comparing SME dedicated exchanges (alternative markets) and prime market, key distinct parameters are: size, access, liquidity, market dynamics, and innovation (Yoo 2007). Key features are presented in the following table.

[10] However, MTF is not synonym for SME dedicated exchange venue. In fact, great majority of MTFs as new trading venues offer trading in blue-chips. Unlike the regulated exchanges (managed by market operator), MTFs can be managed by either market operator or by investment companies and investment banks.

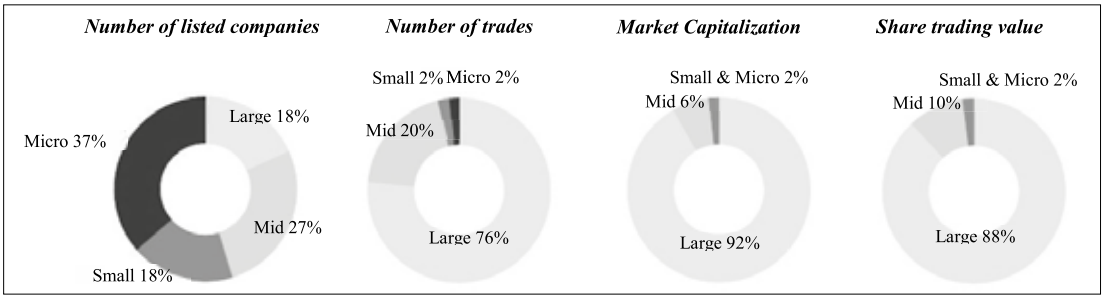
Table 2. Performance indicators of SME exchanges

Stock exchange Parameters	SME exchange	Main market
SIZE	Significantly smaller in terms of *turnover* and *market capitalization*.	Generally, bigger in terms of *turnover* and *market capitalization,* especially in developed markets.
ACCESS	*Size of financing* (amount and equity offerings) and *number of listed firms* is generally smaller, although this varies among particular SME exchanges.	*Size of financing* (amount and equity offerings) and *number of listed firms* is generally bigger.
LIQUIDITY	Measured by *turnover ratio.* Differs significantly among SME exchanges. Generally, liquidity is lesser compared to the main markets.	Differs significantly among main markets. In developed markets, liquidity is abundant compared to frontier and emerging markets.
MARKET DYNAMICS	Measured by *listing ratio* (new listings to total listings) and *delistings ratio* (delistings to total listings). Differs significantly among SME exchanges.	Differs significantly among main markets. Depends on variety of factors.
INNOVATIVENESS	Measured by *industrial characteristics of the listed firms*. Differs significantly among SME exchanges.	Differs significantly among main markets.

Source: Author summary based on Yoo (2007).

How much significant are SMEs markets in terms of the overall market capitalization and value of share trading? In order to get broader picture of today`s SME financing using stock exchange we use data obtained from WFE 2013 Market Segmentation Survey. Although small and micro-cap accounted for 82% of the total number of listed companies, they have much lesser importance in terms of market capitalization (8%) and value of share trading (12%). The share of each market segment in each indicator for WFE members is presented in Figure 2.

Figure 2. Share of each market segment in each indicator for WFE members



Sources: WFE, 2013 Market Segmentation Survey.

Other study showed that from sample surveyed in 2013, only 5% of SMEs in Europe issued tradable equity and 2% issued debt.[11] Although certain presented figures can be misleading in terms of understating the importance of the stock exchanges in financing SMEs, equity financing can help SMEs to avoid certain constraints related to bank financing (e.g. collateral) and to focus on long-term financing source that does not need to be paid back. It increases SME`s capacity to carry more debt financing in balance sheet. Moreover, financing via stock exchange increases and diversifies investors base, increases SME`s visibility and credibility associated with corporate governance standards.

3. POLICIES TOWARD IMPROVING GROWTH OF SME EXCHANGES

With the basic infrastructure in place (e.g. technology, transparency, information disclosure, corporate governance, depository, clearing and settlement, financial markets supervisor, monitored investment firms etc.), initiatives, if any, toward stimulating funding of SMEs through majority of local stock exchanges in less developed markets in EU countries have been fruitless. Predictably, the majority of less developed markets are lagging in greater initiatives towards supporting financing SMEs via exchange. To be more precise, the majority of stock exchanges in SEE post-transition countries simply have failed to thrive not only in attracting SMEs but also in attracting large issuers. Reasons are manifold and deeply interrelated. Symptoms are painful - these markets have only a few liquid listings, new IPOs are rare, and daily turnover frequently does not exceed few million euros with only a few companies responsible for a large percentage of the total trading. The prospects for these local exchanges does not seem bright as globalization and technology enable larger issuers to dual list on local and global markets, or they simply switch home listing market, preferring foreign global markets versus local ones. In certain local markets issuers sometimes choose to delist themselves as they do not perceive any benefits of being listed.

Yoo (2007) identified four key questions relevant for SME exchanges:

- Why are so few new markets successful, and why do so many others fall short?
- How can new markets improve access to risk capital for innovative SMEs in developing countries?
- How can “light” regulations adapted to SMEs avoid compromising investor confidence in new markets?
- What new policy measures could be adopted other than those for developing main equity exchanges?

In order for SME dedicated markets to flourish, two basic presumptions should be in place. Firstly, benefits of SME accessing capital markets must outweigh the costs and secondly, there should be right balance between adequate investor protection on one side and affordable costs of SMEs` access to capital markets. Size, depth and liquidity of securities markets may present major problems for both, issuers and investors. Highlighted

[11] Peterhoff, D. et al., Towards better capital markets solutions for SME financing, 2014.

by Grose & Friedman (2006:7) "weak, shallow markets without much liquidity are not attractive either to issuers or investors. Issuers will not find such markets to be an efficient source of capital and are likely to continue to find bank financing to be less expensive than the market, particularly when the issuer may have a long standing relationship with a particular bank. Investors, especially foreign investors, will not find many investment opportunities in such markets, and may well be worried about the risks they are assuming in investing in a market with little transparency or depth… weak secondary market mechanisms are thus a key constraint on primary market activity". Similarly, Andritzky (2007) also highlights the dominance of bank-based financing as an obstacle to stronger development of markets. He points that traditionally, the continental European financial culture considers market financing only compatible for larger companies, while SMEs resort to bank financing. The dominance of bank lending has resulted in the lack of equity financing, in particular to start-ups and small and medium-sized enterprises (SME) as bank lending is biased towards existing corporations and securities markets are shallow. In addition, reasons for market failures may lay in narrow focus on high-tech companies, the lack of sophistication of both investors and the regulatory authorities, timing, and inadequate regulatory framework unable to provide incentives for responsible corporate behavior (Grose & Friedman 2006).

Ranked first, major obstacle that impacts investor interest in SMEs is lack of liquidity, followed with lack of research coverage (CFA Institute 2013a), with this two issues inevitably interrelated. Having in mind that shares of SMEs are inherently less liquid, small-sized markets measured with market capitalization and trading volumes furthermore accentuate investors` negative perception. There are several reasons for lack of liquidity outlined in report of ESMA Securities and Markets Stakeholder Group (2012):

- SMEs are intrinsically of a smaller scale than blue-chips which often reduces their attractiveness to large, institutional investors;
- entry of high frequency traders tends to reinforce the attractiveness of blue-chips, sometimes at the expense of SMEs in terms of trading;
- fragmentation of trading landscape induced with MiFID, resulted in higher competition and pressures on the business model of trading venues, encouraging some of them to focus on most profitable segments such as blue-chips trading at the expense of other less profitable segments such as SMEs.

In order to reduce information asymmetries, the liquidity of SME stocks can be improved by research coverage. However, this is rather an unprofitable activity. Lack of investment research discourages investors from investing in SME. However, certain market operators have taken action toward resolving this issue.

So, the main concern is how to structure public market for SMEs in order to expand investors' base and provide them with decent liquidity? The problem is accentuated in emerging and frontier markets as these markets struggle even with liquidity of large cap stocks. Arce, Lopez, & Sanjuan (2011) note that geographic scope of the market may be an issue pointing that a market which does not reach critical mass in terms of the number of listed companies may find it hard to attract the attention of investors. A small sized market in terms of number of securities listed or total capitalization and trading may cause

investors to have a negative perception of the liquidity of the listed securities. Also, the larger the market, the greater its capacity to attract the attention of analysts and brokers who are essential for ensuring the consolidation of the market.

One of the main challenges for liquidity of the SME stocks on certain markets is expansion of the generally narrow and undiversified investment base in developing markets. Even though an alternative market appears to be more suitable for professional (institutional) than for retail investors because of inherent risks, the story of NewConnect case contradicts this assertion. Notably, regulated non-depositary institutional investors such as pension funds, insurance companies and other types of collective investment schemes, must comply with number of investment constraints defined in national legislations and investment policy statements and thus are mainly restricted in pursuing investments in SME stocks listed on second-tier markets. In addition, Grose & Friedman (2006:7) explain that institutional investors generally will only invest in issuers of a certain size in order to obtain the benefits of diversification and to keep the costs of portfolio monitoring under control. They argue that "even in those countries where an institutional investor base has recently developed, there is not a ready pool of capital sufficient to attract small companies. Institutional investors thus have not contributed to the development of the market to the extent one might expect." Although generally less equipped with specialized knowledge and skills, retail investors can efficiently diversify the investor pool, and even represent main investors` base for SMEs. E.g. on NewConnect, alternative trading platform managed by the Warsaw Stock Exchange, the largest proportion of trading was generated by individual investors whose share of trading in the market outweigh domestic financial institutions and foreign investors.

Tax incentives are one of the main ingredients of policies aimed at stimulating investments in small enterprise with growth potential but with little track record. (Arce et al. 2011). The introduction of this type of incentive is mainly based on the argument that the informational asymmetry between the company and potential investors is very accentuated in this type of company, which substantially reduces the number of investors willing to participate in their share capital. Apart from tax incentives, there is another set of measures suggested by practitioners that would possibly contribute to attracting investors interested in SME such as greater transparency, efficient market making mechanism, standardized trading platforms with low access costs, reduced capital adequacy and risk weighting for institutional investors, better sell-side coverage, etc.

In order to protect market integrity, market operators commonly stipulate prerequisite that SME must contract the services of a mandatory partners in order to be admitted for listing, typically licensed advisers (or so called designated brokers) and liquidity providers (i.e. market makers), which may enhance investor protection and decrease the level of fraud, as is evidenced in case of AIM (Cumming & Johan 2011). ICSA (2013) study on financing of SMEs through capital markets confirms that a market making system is instrumental for improving market liquidity for securities issued by SMEs and that dedicated equity markets for SMEs that have market advisors, who assist firms so that they can be properly prepared for listing, have developed at a faster pace after the introduction of

the market advisor system. E.g. for AIM listed companies, the responsibilities of authorized advisor are to obtain a listing and do the following:

- act as a "front-line intermediary";
- required at all times for AIM companies to retain their listings;
- ensure disclosure of time-sensitive information;
- ensure timely release of semi-annual reports;
- assess the quality and accuracy of business plans, management, directors, valuation, revenue forecasts, ability to make timely disclosures.

Similarly, on relatively successful market NewConnect in Poland their formal role includes:

- preparation of the issuer for the entry to NewConnect, including the preparation and approval of the relevant admission document;
- in the period of trading (at least for 3 years) to advise the company on its trading in NewConnect and to support the issuer in complying with the information requirements.

Sometimes, lock-in clause (preventing insiders in selling shares before some predetermined period) and safeguards for minority shareholders in the case of takeovers (as in case of Spanish MAB) can also be imposed together with strict delisting rules. Timely delisting of non-compliance firms contributes to investors` confidence and keeps high level of market integrity.

Another group of measures that targets SMEs towards their greater participation on public markets aims to reduce two types of barriers: cultural and economic (Arce et al. 2011). They argue that former is associated with lack of familiarity of entrepreneurs with securities markets that result in biases against the option of going to the markets. Biases may originate from an overestimation of the costs of being listed on a market and an underestimation of the benefits in terms of diversification of financing sources, reputation and image. In addition, Grose & Friedman (2006) mention other obstacles such as potential for the founder to lose absolute control over the company and concerns over greater transparency. The basic antidote to this cultural barrier is to provide adequate information by financial intermediaries and companies managing the trading systems as suggested by Arce et al. (2011). In several countries, SME dedicated exchanges provide services aimed at nurturing young enterprises that are or will be listed on the markets such as promoting institutional investment, boosting the visibility of the listed firms, and raising public awareness of alternative investments (Yoo 2007).

The economic barrier is related to expenses associated with the listing process. Argued by Grose & Friedman (2006), high cost of external finance, high costs of making an initial public offering (underwriting fees, accounting and legal fees, brokerage charges, printing and advertising costs, and listing fees) and the expense of meeting ongoing governance requirements for public companies (financial and significant event disclosures, internal financial controls, composition and functioning of the board) can provide strong disincentives for a private sector company to list. Costs and expenses of this nature can be prohibitive for smaller enterprises relative to their size. Yoo (2007) points that successful new markets are lowering costs for firms by establishing flexible entry requirements, instituting light corporate governance rules, and reducing financial fees for listing and maintenance.

Policy makers in certain countries developed various schemes intended to facilitate the access of companies to the public markets. These schemes may encompass subsidies, loans on favorable terms, grants, tax breaks, and certain forms of technical assistance. However, Arce et al. (2011:35) suggest that "it may be a good idea to examine other formulas which are less of a burden on public funds and more effective in terms of encouraging more diligent behavior on the part of the beneficiary companies"

Clearly, finding the right balance between costs for the issuer and investor protection is more of an art than the exact science. Properly designed, legal and regulatory framework may support achievement of this objective. Grose & Friedman (2006:8) state that "although legal and regulatory measures cannot overcome all of these difficulties, and many other factors, including, primarily, the macro-economic environment, are critical, an appropriately designed and effective legal and regulatory framework can help to encourage market growth and to increase access to finance for all companies, including small and medium sized enterprises". Taking into account typical characteristics of many emerging markets, the obstacles to development that they face, and the difficulty of competing with global markets, policy, aforementioned authors suggest that policy makers should focus on development of a primary market that can provide capital to small and medium sized domestic companies, and related reasonable legal and regulatory framework that should not be a replica of regulatory environment in more developed markets but, instead, should concentrate on what is "necessary" rather than what would be "nice". In fact, according to Chemmanur & Fulghieri (2006:483) "reposing all regulatory authority in a centralized agency and adopting a "one size fits all" approach may affect the economic viability of value-maximizing exchanges, since, in order to survive, they need the flexibility to optimally tailor their listing standards to their pool of applicant firms, with the quality of this pool varying as a result of competitive pressures from other exchanges". According to CFA Institute (2013b) view, to achieve balance between easier access of SME to capital markets and investors protection, the following safeguards are needed:

- such companies must get audited annually and include the auditor's report in an annual report to shareowners and investors;
- such companies should provide at least semi-annual updates on performance and financial condition;
- such companies should have to disclose all important company news through normal public distribution channels;
- company principals should be liable for fraudulent representations made in offering documents, financial statements, or company announcements delivered through these channels;
- the shares of such companies should trade on exchanges or trading platforms dedicated to companies that take advantage of the limited reporting options to ensure investors are aware that such companies do not have to adhere to the same transparency and governance requirements as traditionally listed companies.

The consolidation processes of market operators, development of major alternative trading venues (e.g. MTFs), and technologically supported trading solutions enabled even SME companies to be easily listed on international non-domestic markets without incur-

ring additional expenses compared to local market listing, with benefit of exposing itself to broader investors base.

4. ZAGREB STOCK EXCHANGE AND SMES LISTING

According to SME size criteria used by WFE or FESE, majority of listed companies on these (local) markets are micro, small and middle companies. The comparison of EU definition of SME and of stock exchange associations "clearly shows that the current EU Commission definition is too restrictive if the aim is to focus on the promotion of financing of SMEs by capital markets. Even for smallest exchanges, the number of SMEs according to EU definition[12] is smaller than the number of micro-cap" (Naacke & Hirsch 2013), and only SME companies according to EU criterion could be targeted by public schemes.

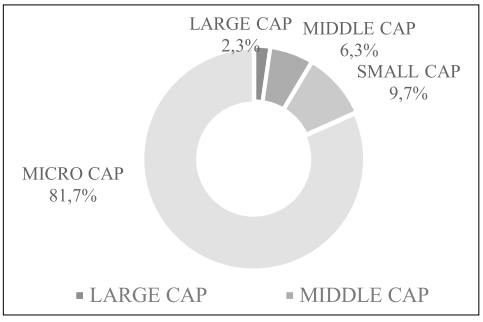
Illustratively, according to criteria, only four (WFE criteria) or five (FESE criteria) companies on Zagreb Stock Exchange would be classified as large cap companies (INA d.d., Zagrebačka banka d.d., HT d.d., and PBZ d.d., ADRIS Grupa d.d.) with approximately 80% of the listed companies classified as a micro companies, although some of them would not satisfy the SME definition according to EU criteria.

Table 3. Classification criteria for companies listed on Zagreb Stock Exchange

Criteria	LARGE CAP	MIDDLE CAP	SMALL CAP	MICRO CAP	Total
WFE	4	11	17	143	175
in % of total companies	2,3%	6,3%	9,7%	81,7%	100,0%
FESE	5	9	22	139	175
in % of total companies	2,9%	5,1%	12,6%	79,4%	100,0%

Source: Author (based on ZSE market capitalization data).

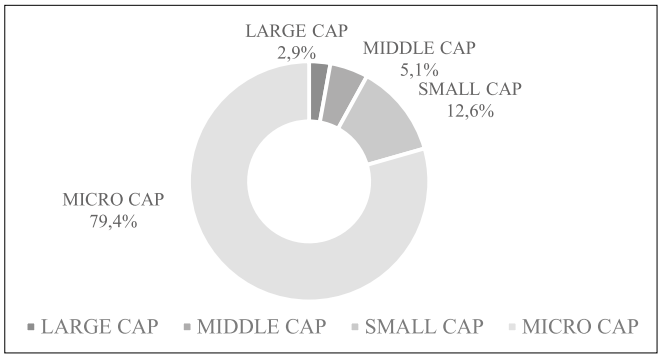
Figure 3. Market capitalization structure on ZSE (WFE criteria)



Source: Author (based on ZSE market capitalization data).

[12] Definition by the EU Commission was set up in the context of state aid and is thus very restrictive and not quite suited for purpose of government schemes in supporting SMEs fundraising through stock exchanges. The critiques of this definition can be found in Annex II of Report on Helping Small and Medium Sized Companies Access Funding (ESMA Securities and Markets Stakeholder Group 2012).

Figure 4. Market capitalization structure on ZSE (FESE criteria)



Source: Author (based on ZSE market capitalization data).

Evidently, according to size of the listed companies, we may argue that Zagreb Stock Exchange taken as a whole actually has features of SME stock exchange, especially when comparing ZSE (without first five large-cap companies) with specialized SME segments of more developed exchanges, members of the FESE.

Table 4. SME segments of stock exchanges, members of FESE

Exchange	SME Segment	Market Capitalisation (31 Dec 2015, EUR mil.)	Electronic Order Book Transactions (2015, EUR mil.)
Deutsche Börse	Entry Standard	44.100,6	3.963,9
Euronext	Alternext	13.458,0	5.656,0
NASDAQ Nordics & Baltics	First North Alternative Market	8.589,1	3.621,7
Warsaw Stock Exchange	NewConnect	2.041,8	411,8
BME (Spanish Exchanges)	MAB Expansión	1.811,8	n.d.
Oslo Børs	Oslo Axess	1.316,0	762,9

Source: FESE Statistics.

At the end of 2015, ZSE had market capitalization in amount of EUR 16.900 millions, and without five large-cap companies, market capitalization was EUR 7.290 million. However, such capitalization does not translate into a proportional increase in the turnover. Even with EUR 314,8 millions in total annual orderbook turnover in 2015, ZSE is lagging specialized SME segments of the developed exchanges. Turnover of the ZSE is one of the lowest among the stock exchanges in EU and is basic shortcomings of the ZSE. The obvious consequence of that is weak interest of investors and trend of delisting of certain numbers of companies.

It does not seems plausible for local stock exchanges such is ZSE to focus itself in attracting regional large cap enterprises that seek global visibility, much broader investors base with much larger funds appetite. Nonetheless, under certain conditions ZSE as a leading regional stock exchange may represent regional hot-spot at least for small and medium enterprises in search for better access to local equity finance. With well-developed infrastructure in place, Zagreb Stock Exchange should balance the objectives of further integration with capital markets in EU on the one side, and enhance development of the markets specifically tailored to needs of the local and regional SMEs. While implicit costs (such as regulatory and reporting compliance with stock exchange rules) can be high, taking into account high explicit costs of listing on some other renowned exchanges, ZSE`s listing entry fees and listing maintaining fees for regular market segment and MTF may be the case in point for listing local and regional SMEs.

Table 5. ZSE listing and listing maintenance fees for shares

Column1	Regular Market	MTF
Processing fee	HRK 500 (EUR 66)	HRK 500 (EUR 66)
Listing fee	HRK 35.000 (EUR 4.605)	HRK 6.000 (EUR 789)
Listing maintenance fee	HRK 20.000 (EUR 2.632)	HRK 3.000 (EUR 395)

Source: ZSE Price list (valid from 24 April 2015).

Considering developed local institutional and regulatory infrastructure but limitations as well such are undiversified and narrow investors' base, "equity culture" and illiquidity, ZSE should search for prosperity by directing its efforts towards creating tailor-suited platform for regional and local SMEs. Such efforts should encompass not only integration into regional alliances, but also careful design of regulatory environment more suited to particular needs of SMEs.

5. CONCLUSION

One of the main challenges nowadays for SMEs growth and development is to ensure access to external financing. While there is an entire set of external financing alternatives, one particular form of *equity financing* gained closer attention of various stakeholders - notably, financing through specialized types of stock exchanges dedicated to SMEs. Development of SME dedicated exchanges may enable SMEs easier access to equity capital. There are additional advantages for enterprises raising funds through stock exchange such as the diversification of funding sources, access to broader base of potential investors' base, access to equity capital. It generally enables carrying more debt in balance sheet, and may bring brand recognition and reputation. On the other side, this too may represent impetus for creating vibrant environment for stronger development of local capital markets. Whereas in some markets specialized SMEs exchanges have already yielded results (e.g. NewConnect market of the Warsaw Stock Exchange), certain markets such is Zagreb Stock Exchange still struggle with structural deficiencies. Some of the obstacles are lack of financial

literacy, absence of "equity culture", narrow investment base, utter insensibility and lack of support of government policymakers for development of capital markets in general. Designing suitable architecture for SME dedicated exchanges in developing countries takes time. In order for SME dedicated exchange to prosper, for each country separately, unique tailor-made approach must be designed and implemented. This can be apply for Zagreb Stock Exchange as well.

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