COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 25.10.1995
COM(95) 498 final

COMMUNICATION FROM THE COMMISSION

Reporting on the feasibility

of the creation of a European Capital Market

for smaller entrepreneurially managed growing companies

CONTENTS

I. INTRODUCTION

1. In its Decision of 14th June, 1993[1] approving the multi-annual programme of DG XXIII, the Council asked the Commission to examine the opportunity and feasibility of supporting the development of secondary stock markets within the European Union. That is, capital markets more suited to the listing of shares in smaller companies seeking access to long-term equity capital than were the main European markets then in existence.

2. In their Memorandum of 1st October 1993, "Small and Medium-sized Enterprises, Motor of European Growth", the Belgian Presidency laid particular stress upon the need for smaller growing firms to enjoy better access to sources of long-term equity capital.

3. The Communication of the Commission to the Council of 10th November 1993 "On the financial problems experienced by small and medium-sized companies"[2] confirmed the existence of a problem for smaller rapidly growing firms in obtaining access to sources of additional long-term equity capital. This in turn limited their rate of growth, often to the detriment of the development of products based on new technologies, and had negative implications in terms of job creation.

4. In its Opinion on the above Communication[3] the Economic and Social Committee called on the Commission to "carry out a feasibility study on the establishment of a recognized European market giving European firms, especially small firms, access to (risk) capital."

5. In its Resolution on the improvement of the fiscal environment for SMEs[4] the European Parliament asked the Commission to coordinate exploration of the idea of establishing a European capital market for SMEs.

6. In the Decision of 15th December 1994 approving the Fourth Framework Programme for Research and Technology,[5] Activity 3 and adopting the specific programme for the dissemination and valorisation of research activities (Innovation programme), the Council considered that in order to reach the objective of improving the financial environment for the dissemination of technologies, it was necessary to support "the development or establishment of effective systems for mobilizing private capital, including investment exit mechanisms".

7. In the Resolution of 7th April 1995 on high-tech industries, the Commission was asked by the Industry Council to report to the Council on steps already taken to assist smaller firms operating in this area, especially in

---

1 93/379/EEC

2 COM(93) 528 final

3 IND/521 of 6.07.94

4 A4-0024/94, Point 23

5 OJ L361 of 31.12.94, page 101

regard to the development of a pan-European capital market to promote outside financial participation in such SMEs.

8. This report seeks to respond to the above request by setting out progress made to date and the obstacles that still lie in the path of creating an effective, liquid and financially viable capital market for shares in fast-growing and entrepreneurially managed companies at the European level.

II. EUROPEAN CAPITAL MARKETS AND THE NEEDS OF SMEs.

9. The common objective of the Member States and the European Commission to foster improved competitiveness by industry and the creation of new employment is being partially undermined by the restrictions imposed on the growth of fast-growing and entrepreneurially managed companies by their difficulty in accessing long-term equity capital. One study[6], conducted with the support of the European Commission and published in the Spring of 1994, reported that a quarter of the firms contacted cited shortage of finance as a constraint on expansion. In addition, the recent Community Innovation Survey of more than 40,000 firms in fourteen European countries confirmed that difficulty in accessing sources of appropriate finance was one of the most frequently identified barriers to innovation.

Regular injections of equity capital are needed by companies in the fast-growing category and at levels which frequently far exceed those the proprietors are able to find, either from their own resources, private investors (commonly known as "business angels") or the banking sector. Venture capital funds have been one source, but they wish to exit from their investments eventually. If they cannot achieve this through the floatation of shares on a stock market, the only realistic alternative is to sell their holding to another company, so removing or limiting the control of the original entrepreneurial founders. This, as was pointed out in the Communication referred to under Point 3, may of itself have undesirable consequences in terms of future growth.

10. In the United States of America the National Association of Securities Dealers Automatic Quotation (NASDAQ) electronic stock market, in particular the NASDAQ Small Cap section, provides suitable smaller companies with ready access to long-term equity capital, through the medium of a public offering of their shares and a subsequent listing on the market, as well as bringing the increasing benefits of networking, utilising the developing information society, to traders in stock market securities. It would seem, according to a San Francisco based research organization[7] that some 95% of US firms backed by venture capital are eventually listed on NASDAQ, although for one of the largest US funds the figure is actually 88%. In either instance, the figure is highly significant.

---

6 European Business Survey

7 VentureOne

Equally important is that twenty per cent of the Initial Public Offerings (IPOs) on NASDAQ are high technology related. This compares with only ten per cent of the IPOs on the six main national stock exchanges within Europe. One explanation may be that thirty five per cent of the companies floated on NASDAQ over the past two years have been loss-making at the time, the products offered not having yet reached the stage of being fully marketed. This would have been impossible on any "official" national stock exchange in Europe (except for biotechnology stocks in London) because their rules do not permit the listing of such companies, with negative implications for European competitivity in a number of important sectors, not least those involved with the information society.

In terms of job creation, a recent report[8] shows that while companies listed on NASDAQ only comprised 0.04% of all US companies, they created almost 16%, or 300,000, of the new jobs in the American economy between January 1990 and June 1994.

11. According to the 1994 report on "European Second-Tier Stock Markets for New Technology Based Firms", which was drawn up by Graham Bannock & Partners at the behest of the Commission services, and in practice looked at fast-growing SMEs of all types, main national stock markets were neither equipped, nor wished, to specialize in small company stocks. This view is supported by the fact that the ten largest companies on the London market account for 23% of total market capitalization, in Paris 25% and in Amsterdam 74%. In Frankfurt between 80% and 90% of all deals are in the shares of the thirty largest enterprises listed. This is not purely a European phenomenon. In the USA the New York Stock Exchange showed a similar lack of interest in the early 1970s, so allowing NASDAQ, together with other more informal markets, to fill the gap.

In the early 1980s a number of national stock markets in Europe did attempt to respond to a perceived demand by creating what were known as "secondary", or more properly, "second tier" markets. Whilst still regulated by national exchanges, they had (and have where still open for business) less onerous listing conditions and on-going reporting requirements than those required for the main market. The problem is that all these markets suffered a steep decline in activity following the 1987 stock market crash and the majority have enjoyed little or no recovery.

The result is that whilst 628 companies were listed on NASDAQ for the first time in 1993, the comparative figure for all the second-tier markets in Europe combined was 31, with 218 companies being admitted to the main European markets. Statistics would indicate this situation is tending to disadvantage the smaller company when it comes to accessing capital markets. It has been calculated that 56% of European companies with more than 500 employees have raised capital by means of a listing on a stock exchange. The figure for those with less than 500 is only 2.2%. The degree of comparative disadvantage is impossible to calculate given the vastly greater number of companies in the latter category and the impossibility of knowing how many would seek external capital given the opportunity, but could well be significant.

---

8 Cognetics Inc., June 1995

Already, the lack of a NASDAQ equivalent, either within a Member State or in the European Union as a whole, has led some of Europe's most promising growing companies to seek a listing on NASDAQ, demonstrating that a market need exists. This move has been fostered by a strong marketing campaign mounted by US investment banks. Some ten per cent of new firms listed on NASDAQ currently come from Europe, with more having been listed in the past three years than in the previous ten. It is understood, but impossible to confirm, that over one hundred European companies are presently involved in negotiations to this end.

The European situation would not appear to result from a lack of demand, particularly by institutional investors. European financial institutions typically buy 20% of the shares on offer when a US company is floated on NASDAQ. When the company is European this rises to between thirty and thirty five per cent. In fact, eighty seven per cent of European financial institutions have reportedly invested in stocks listed on NASDAQ. In addition the Round Table of leading representative from the Banking Sector underlined in its final report[9] the importance of the creation of an active and liquid stock market open to SMEs.

12. In the light of recent developments (see Point 13), it would appear that some national European exchanges are becoming aware of the need to provide markets more attuned to the needs of the smaller company, as well as those who might possibly invest in their shares. Not altogether surprisingly in view of differing national rules and cultures, national stock exchanges are intending to build from the bottom up, including harnessing local and regional investor interest in the shares of companies with which they may be familiar, largely ignoring the wider European requirements and apparent opportunities in the process.

Whilst the eventual linking of markets is envisaged, enabling a measure of cross-border trading to take place, it will probably be some time, except in the case of the proposal for a Nouveau Marché by the Paris stock exchange, before any concrete proposals are tabled. Even then, they are initially of a bilateral nature and will require substantial efforts over a long period in order to reach the critical mass necessary to excite investor interest and ensure a sufficient level of liquidity. At the same time, a pan-European market should provide substantial new business opportunities for financial institutions participating in stock market activity, including those in the regional financial centres.

13. Once European firms have listed on NASDAQ, and given their almost certain need to make further share issues, the advice of their investment bankers is likely to be that this would be easier if the company had a higher profile within the USA through concentrating expansion in that country. This counsel is likely to be followed, not least for commercial reasons, as only firms already having at least twenty per cent of their turnover in the USA are really suited to a NASDAQ listing. A possible result is that Europe will lose the main economic benefits arising from products and processes developed there. Also, firms which neither meet existing listing requirements on national European stock exchanges, nor have a sufficiently large market in the USA to go to NASDAQ, are effectively barred from raising capital on public markets. Even if a national initiative such as the British AIM Market is successful, this will still

9 19.05.94

leave a majority of Member States without such facilities for the foreseeable future (the developments proposed in Germany, Italy and elsewhere being anticipated to take some years to reach full fruition), indicating the need for a European-level solution.

14. Until now it has been difficult to contemplate the creation of a true pan-European stock market because of existing fiscal, regulatory and other barriers. With the coming into force of certain Community legislation, most importantly the Directive on Investment Services in the Securities Field[10] on 1st January 1996, the opportunities will improve markedly.

15. Appreciating the new possibilities arising because of the new European-level legislation, the Commission considered the options open to it in furthering the concept of a pan-European capital market offering similar advantages for smaller companies seeking to raise equity capital to those provided by NASDAQ. It soon became evident that the most appropriate role it could play was to investigate the degree of interest existing among influential members of the financial community in creating both a European equivalent of the American Association of Securities dealers, for which the NASDAQ electronic trading market is provided as a service, and, in due course, a new privately financed and operated European level stock market. In order to pursue this objective, informal meetings were held with members of the financial community from July 1993 onwards. Whilst it was found that a degree of interest existed, it was clearly going to be necessary for an existing organization to act as a catalyst if a meaningful feasibility exercise was to be launched.

III. THE FEASIBILITY STUDY CONDUCTED BY THE EUROPEAN VENTURE CAPITAL ASSOCIATION.

16. Arising out of the discussions held with the European financial community, a request was received in December 1993 from the European Venture Capital Association (EVCA) for financial support towards the carrying out of a feasibility study into the possible creation of a European capital market for entrepreneurial companies. Following careful examination of the extensive dossier presented, a decision was taken, on 22nd February 1994, that the costs of this exercise should be shared, EVCA appearing likely, given its wide range of contacts, to adequately fill the role of catalyst.

17. Work on the study was commenced immediately the decision on financial support was made. Bilateral discussions having been conducted between EVCA and a range of parties, a decision was taken to form a working group to consider the wide range of issues involved, with the objective of submitting a feasibility report by the end of the year.

18. A meeting, held in Paris on 28th and 29th June and attended by nearly seventy persons, agreed, with but one exception, that the creation of a European Association of Securities Dealers (EASD) and a European Capital Market for Entrepreneurial Companies (EASDAQ), the latter operating in full conformity with the Community legal order, was required. To that end the Working Group was to be transformed into a Steering Committee, charged

---

10 93/22/EEC

with drawing up blue prints for the EASD and EASDAQ, as well as organizing an inaugural general meeting of the former body.

19. An inaugural meeting of the EASD, was held in London on 15th November. The Steering Committee's report was endorsed and it was confirmed in office, pending the election of directors at a first General Meeting to be held later. Also, five working groups were set up to consider various aspects of the operation of a pan-European capital market.

20. On the following day a conference setting out the case for EASDAQ took place. Some 200 delegates attended, including representatives of fifteen stock exchanges and an impressive array of major investment houses. The majority appeared to support the objective of establishing an electronic, screen-based, capital market for Europe's most rapidly growing companies, whether by EASDAQ or another party, although this support must be judged as being tentative, given the absence of a final blueprint.

21. At this point the EVCA feasibility study was judged to have been successfully completed. It must be emphasised that the creation of the European Association of Securities Dealers had come about entirely because of the degree of support shown by the financial community. The Commission was not involved in day to day developments, neither did it try to influence the outcome of the various discussions that took place.

IV. THE EUROPEAN ASSOCIATION OF SECURITIES DEALERS.

22. The EASD has been established with the objective of improving the availability of securities markets, both at the European and national level, which are more accessible to smaller, entrepreneurially managed, high-growth companies. It will also seek to stimulate the interest of potential participants (investment houses, market makers, brokers and dealers) in markets of this type. In order to further these objectives it will:

- advise on the creation and development of the new EASDAQ market, acting as a bridge between regulatory and policy makers, issuer's of stock, securities dealers and investors, as well as identifying best practice;

- make policy recommendations, based on best practice, on the establishment and functioning of regional and national markets for small company securities;

- work towards achieving changes in the legal, fiscal and regulatory environment, when these appear to be impeding the attainment of the above objectives;

- provide a unique pan-European forum for all involved in the market for small company securities by providing information, training (particularly in skills currently in short supply in Europe such as market making), organizing conferences, commissioning studies etc.

23. Full membership of the EASD will be reserved for individual companies and organizations actively involved in the trading, analysis and sponsoring of small company stocks. Associate membership will be open to individual companies and organizations having a commercial or policy interest in the activities of the

EASD. The target is for it to have 100 full and 25 associate members by 1st July, 1996.

24. The relationship between the EASD and EASDAQ S.A., has been defined in a Memorandum of Understanding, signed on 2nd May 1995. This sets out that the EASD will:

- assume all regulatory duties relating to the membership of all broker dealers who trade on EASDAQ (a parallel to the arrangement between the National Association of Securities Dealers and NASDAQ);

- approve professional standards relating to the training, examination and registration of individual brokers and dealers;

- approve the admission and dismissal of member firms;

- approve, subject to the ultimate responsibility of EASDAQ, disclosure and admission rules and procedures and the continuing obligations for issuer's, as well as trading clearing and settlement rules, prior to their submission to the regulatory authorities.

In addition the EASD, in order to ensure a balanced representation of all market interests, will have the power to nominate one third of the directors serving on the board of EASDAQ, as well as to jointly propose, along with the shareholders of EASDAQ, a further one third.

The closeness of the association between the EASD and EASDAQ is to some extent an accident of history. At the time the EASD was formed there was only one proposal, from EASDAQ, for a pan-European capital market for smaller companies. As a non-profit making professional organization it will obviously have to be prepared to become involved with other projects to the extent asked for by their sponsors. It is encouraging that a director of the EASD is now also serving as a director of the French Nouveau Marché.

25. Given that it should make a positive contribution towards achieving the political objective of overcoming the problem of access to additional equity capital, at the appropriate level (European, national or regional) by the most promising smaller companies within the European Union, and in line with precedent, the Commission made a contribution towards the running costs of the EASD during the first eighteen months of its life. Thereafter, it will have to be fully financially self-supporting.

V. PROPOSED EUROPEAN CAPITAL MARKETS.

EASDAQ:

26. The result of the Commission's investigations into the feasibility of creating an improved access to equity capital for SMEs, as asked for by the Council, has been to directly stimulate one concrete pan-European initiative, the EASDAQ (European Association of Securities Dealers Automated Quotation) market. Its development and operational plans are described hereafter in some detail.

PROGRESS MADE TOWARDS ITS CREATION.

27. In September of 1994 an understanding was reached respecting the possible creation of a pan-European market for Entrepreneurial Growth Company Shares. The parties to this agreement were EASDAQ-UK (a group of influential personalities in the UK financial sector), SBF-Paris Bourse (which has now developed its plans for a competing market, a description of which follows), the US NASDAQ market and the European Venture Capital Association. The objective was to create an operational market by early in 1996 and this still remains valid.

28. By March of 1995 procedures had been commenced to give it legal personality as a Société Anonyme under Belgian law, a Director of Operations had been appointed; offices established in Brussels; and moves initiated to raise an initial ECU 1 million in capital through a private share issue. A sum raised successfully.

THE STRUCTURE OF THE MARKET.

29. Originally it was hoped to establish a holding company, together with subsidiaries in the main European financial centres, each of which would apply for "regulated" status, but this idea was abandoned in the face of technical difficulties. This may well mean that EASDAQ will, at least initially, be only established and regulated in one Member State, although trading would take place across Europe. This would be conducted entirely electronically, bringing the benefits provided by developments in telematic information and dealing systems to all dealers in securities willing to avail themselves of the opportunity, even if located in the peripheral and less developed areas within the European Union. This is because the market, as a direct consequence of the provisions of the Investment Services Directive, would be open to all authorized and approved dealers in securities. Any adverse consequences flowing from regulatory difficulties, including that described above, will be subjected to detailed examination in Section VI.

30. It is intended by its organizers that:

- EASDAQ should cater primarily for European entrepreneurially managed growth companies with trans-national aspirations, whatever their size and age, but not to the exclusion of other companies that might be of interest to investors. Companies would have to apply to be listed on the exchange and would be selected on the basis of their growth, profit potential and strategy for future development. Many of those receiving approval would be characterised by a higher risk, and potentially higher return profile, than is normally to be found in the case of companies seeking listings on existing national stock exchanges within Europe. In addition:

- the primary objective of most companies coming to the market should be to obtain funding for their development;

- the market would be open to both private and institutional investors, who would, uniquely in Europe, be represented on the Board of Directors, and in addition would enjoy equality of access to the market and to sensitive information. Strict rules would exist against both fraudulent activities and insider trading;

- the market would be operated with efficient trading and settlement systems, using some NASDAQ-type facilities to provide the trading platform and market surveillance.

31. Share trading itself will mainly be based on the market making system, with two or more financial houses maintaining a competitive market in each share listed. This will require their being prepared to quote buying and selling prices for the stocks in which they are making a market at all times, with this information being freely available to all traders having authorised access to the trading system. They will also need to hold a sufficient supply of shares to enable them to meet demand. At least at first, an order matching facility will also be provided. That is, trading being conducted on the basis of the matching of buying and selling orders. One problem to be faced, is that the practice of market making in shares, as opposed to bonds, is currently virtually unknown in continental Europe and will have to be developed. This is a lack the EASD intends to remedy through its provision of professional training services.

32. All companies seeking a listing must have the equivalent minimum legal status in each Member State and will have to issue a prospectus fulfilling the requirements set out in the Council Directives coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public[11]. In order to be mutually recognized in different Member States, the prospectus will have to be drawn up with the same level of detail as required for the listing prospectuses needed in the case of admission of securities to official stock exchanges[12]. In addition, whether or not strictly required under the rules of the exchange, it is likely they will secure sponsorship by an EASD member firm. The company will certainly be under a continuing obligation to provide details of all price sensitive information to the market, as required under Community legislation[13].

33. Whilst the promoters of the market would prefer all trading to be conducted in ECU, this is likely to be impossible before the creation of a single European currency, because of the significantly higher transaction costs levied on ECU transfers compared with those in national currencies. As a result, it is likely that each firm will be given the option of choosing the currency in which its shares will be traded, although dealing screens will show at least an equivalent current price in ECUs. The need to operate in a variety of currencies will undoubtedly hamper the activities of any stock market endeavouring to build a high level of cross border trading activity, proving another persuasive reason for the introduction of a single European currency at the earliest practicable date.

34. Given the proven success of American Depositary Receipts it is probable that trading will be on the basis of Depositary Receipts rather than the underlying share certificates, which will be lodged with an approved bank.

---

11 89/298/EEC & 90/211/EEC

12 Directive 80/390/EEC

13 89/592/EEC

35. It is apparently intended that EASDAQ should not directly compete with existing European stock exchanges operating at national or regional levels, but instead exploit an identified market niche, with an estimate of only some five hundred companies being listed after five years. Many companies will have an unsuitable profile for EASDAQ and will need to be accommodated on improved national "small company friendly" stock markets. Stimulating the creation of the latter, over and above those already announced, would appear to be something meriting a high degree of political priority across the European Union.

THE NOUVEAU MARCHE:

36. Proposals for a Nouveau Marché were first revealed in February of 1995 by the Paris Bourse, of which it is a fully owned subsidiary. According to the Paris Bourse[14], the current objective is to create a Europe - wide network of financial centres open to dynamic companies, all using a single set of listing and trading requirements. To date, only the Brussels Bourse has entered into an agreement to participate.

37. The market will be highly regulated and open to all European based financial intermediaries licensed to operate by the Société Nouveau Marché. These will fall into three main categories:

- Sponsor/Market Makers, who will bring companies to the market, subsequently making a market in their shares;

- Broker/Dealers, dealing in securities both for clients and their own account. They will also be able to sponsor companies coming to the market for the first time providing they are able to enter into a contract respecting future share dealings with a market maker;

- Clearers, who will net transactions between those operating in the market.

38. It is intended to target companies falling into the following categories:

- recently founded companies seeking finance for a specific project;

- high technology businesses with a heavy focus on new product development;

- entrepreneurial companies with a high growth potential;

- family owned companies seeking to widen their shareholder base;

- expanding companies intent on entering a new stage in their development.

14 In July 1995

39. Recent research[15] has identified about 4,500 potential candidate companies who could meet the listing requirements, either now or in the near future. In terms of capitalization, size of assets etc., entry conditions will be similar to those for the NASDAQ SmallCap market. In addition the services of an approved market maker will have to have been secured; a prospectus issued; permanent on-going provision of information promised; and, written agreement by the company's founders and its management to retain for three years 80% of the shares held at the time of the initial listing. For companies in business for less than two years, the "lock in" increases to 100% during the first two years following listing, reducing to 80% in the third. In addition, 10% of total shares in issue must be put at the disposal for the market maker in order to ensure a liquid after market.

40. Trading will be through a mixture of market making and a central order book, with two price fixings per day for the latter. Details of the clearing and settlement system have still to be defined.

41. The market is projected to be launched in February of 1996. It is hoped to attract thirty companies in the first year, of which eight have already been specifically identified and fifty per annum thereafter.

ESSENTIAL CONDITIONS FOR THE SUCCESS OF THE NEW MARKETS.

42. The opinion of potential market participants appears to be that, in order to be successful, European level capital markets will need to be promoted, both to companies and investors, far more intensively than has been the norm for stock exchange services in Europe, although London in particular is clearly recognising the need for a more entrepreneurial approach. The need to continually convince new companies to seek an initial listing is illustrated by the fact that, whilst 3,401 new listings took place on NASDAQ between 1983 and 1992, 2,552 companies were de-listed because of bankruptcy, merger, takeover, transfer to another exchange, or a return to private company status.[16]

This also indicates the need for the continuing development of a stream of suitable candidate companies, particularly those involved in high technology areas showing particular promise of rapid expansion. For this to come about, measures to alleviate the financial factors retarding their development (see Point 9) also need to be considered. Nevertheless, the current situation within the European Union appears to be quite encouraging. A study, launched at the behest of the Commission within the SPRINT programme, found that the number of companies which were potential candidates for listing on a European capital market was large enough to indicate likely operational viability.[17] Whether this would apply equally in the case of two or more competing markets remains to be seen.

---

15 by INSEE, ANVAR, SBF

16 Nikko Research Centre

17 See Annex B

43. Another essential requirement is that the market should enjoy a high degree of liquidity, so ensuring that it is possible to easily buy and sell shares in a particular company, although obviously this will depend on the amount of shares in public issue and the number of shareholders. Without the ability to easily trade blocks of shares of a reasonable size, institutional investors will rapidly lose interest. This is one of the reasons for the relative lack of success of existing second-tier stock markets in Europe.

On NASDAQ the liquidity situation is much better. Contributory factors include the requirement that there should be a minimum of one hundred shareholders and that a reasonable number of shares are made available. Another, is the availability and accessibility of well researched information. Many companies are relatively unknown and, without the availability of regularly produced research reports of high quality, investors will not have confidence to invest. Companies know this and tend to choose their NASDAQ sponsors on the basis of their reputation for good and continued research. The development of a similar level of research in Europe is regarded as essential if any pan-European market is to be successful.

44. It is also important that all operations be cost-effective, enabling listing and membership fees to be kept at a realistic level.

45. A notable feature of NASDAQ has been that firms, even those having acquired an international reputation, have mainly remained on the market rather than listing on the New York Stock Exchange. A problem with national second-tier markets in Europe has been for the tendency of the successful companies, even those only moderately so, to move to a listing on the main market. This has left the second-tier market with the weaker stocks, devaluing it in the eyes of potential investors. It is important that European level markets be so designed as to encourage firms to maintain their presence on them, even should they have grown to the point where they would easily be accepted for a listing on national main markets.

46. If the objective of securing better SME access to external sources of equity capital is to be achieved to any significant extent, it will be necessary to ensure that the owners of suitable companies are encouraged to bring them to the market and the interest of a considerable number of potential investors is stimulated. This requires that both should have a high degree of confidence regarding the regulation of such stock markets and the probity of those operating within them, especially at the point when a first pan-European stock market is launched.

47. Consequently, in their own best interests, the rules and regulatory standards applicable to these new markets, should match the best in force within Europe. In addition, the practices of market makers, together with the remuneration for their activities, needs to be made as transparent as possible.

Investment banks and similar institutions nominated as underwriters and sponsors of new issues will need to maintain the highest ethical standards, particularly in ensuring the equality of access by investors to new issues. In addition, practices which are designed to ensure a new issue enjoys a substantial premium over the offer price during early dealings, only to be followed by a decline in the share price, to the loss of those buying in the market, need to be avoided.

48. The matters raised above essentially require the attention of supervisors of stock markets rather than the introduction of new legislation. It is believed that they can be dealt with perfectly adequately within the rules governing the operation of these exchanges, without restricting the opportunities of securities dealers to make an adequate profit on their activities and to fund the required high level of research into companies in whose shares they deal.

VI. POTENTIAL REGULATORY AND OTHER BARRIERS TO THE CREATION OF A PAN-EUROPEAN CAPITAL MARKET.

49. Without the timely and accurate implementation and transposition into national laws of the Investment Services and Listings Directives, the creation of any market with pan-European trading aspirations, or cross border developments by existing capital markets, would be hampered, with the probability of projects being delayed. Given the critical importance of ensuring optimum access to equity capital for firms of all sizes within the European Union, but particularly fast growing SMEs, it is incumbent on both the Commission and the Member States to ensure that problems in this area do not occur.

50. The responsible Commission services, have been anxious to ensure that any potential barriers and significant problems faced by stock exchanges within the European Union be isolated. In response to Council Resolution 92/1218,[18] a series of studies on various aspects of Internal Market integration have been launched. One of these specifically examines capital market liberalization, as will a separate private study being sponsored by the European Capital Markets Institute. Areas to be examined, which are relevant to the operation of pan-European trading in shares, include:

- operations in securities normally on capital markets;
- the physical import and export of securities;
- obstacles restricting the investments of institutional investors;
- fiscal factors such as taxation of savings, capital gains, stamp duty etc.;
- the impact of exchange rate uncertainty; and,
- the clearing and settlement of securities.

Completion of both studies is anticipated by 31st December 1995.

51. Until these studies have been received and examined by the Commission services, it is impossible for a definitive view to be taken as to what serious barriers exist and possible actions that might be taken. Meantime, however, it is possible to report on a study carried out by the EVCA Tax and Legal Committee, which has been made available to the Commission services. This would indicate that problems principally exist in relation to: the challenges faced by regulators in coping with the new issues presented by a European market in financial services; restrictions on pension fund investments in

---

18 OJ C 334/92, 18.12.92

unlisted securities; an anomaly in the transposition of the Prospectus Directive in one Member State; capital gains tax and, the taxation of dividends. Comments on each of their findings follow, although these may require modification in the light of the studies being carried out for the Commission.

52. The enhanced liberalization of the financial markets as a result of EU legislation is going to bring major challenges for national regulatory bodies, not least where the prompt approval of prospectuses is concerned. This could particularly apply where a non-Belgian company wished to list on EASDAQ. Presumably the same situation would apply in the case of a non-British one on AIM, or a non-French one on the Nouveau Marché. In order to avoid inordinate delays in the approval of floatations by the home State of the company involved, a high degree of liaison between national regulatory authorities appears essential.

It must be anticipated that this will not be the only area in which it may prove difficult for a common approach and procedures to be agreed between regulatory bodies. In order to help them meet this challenge, and to provide a vehicle for the exchange of experience, it would seem logical to organize appropriate arrangements at the European level. This could either be through the establishment of a new liaison group, or the upgrading of the existing Expert Group, which has Members drawn from national regulatory bodies.

53. Given the importance of ensuring the security of sums vested in pension funds, some restrictions on their ability to invest in certain types of security are justified, always providing these are purely for prudential reasons. Hitherto, there has been a widespread view that "unlisted" securities, that is those shares quoted other than on main stock markets, should be subject to quantitative investment limits. This is despite the findings of recent research[19] that investments in a balanced portfolio of high risk/high reward securities actually brings a higher return than obtainable from those in large, well established companies, a concept that has been accepted in the USA for much longer.

In the face of these findings, and where shares are listed on a highly regulated market, but are still classified as "unlisted", it would seem logical for Member States to regard such investments, for the purpose of regulating pension funds, as having "official list" status. At the least, it would seem necessary to ensure that a national pension fund investing in a company of the same nationality quoted on a pan-European market, should not be placed in a worse situation than if that company were quoted on a domestic market with an equivalent level of regulation.

54. In the view of some market participants, a potential problem currently arises in the case of the United Kingdom, where new regulations implementing the Prospectus Directive came into force on 19th June 1995. These rules contain, among others, an explicit provision empowering the London Stock Exchange to grant approval to prospectuses for a public offer of unlisted securities, so ensuring they qualify for mutual recognition in other Member States. The result is that any United Kingdom firm wishing to list on either EASDAQ or the Nouveau Marché would effectively have to have its prospectus approved by a rival stock exchange.

19 Hoare Govett Securities

Whilst it is not suggested the London Stock Exchange would misuse these powers, it does place it in an invidious position in relation to both companies and competitors, as well as laying itself open to challenge in the event of it refusing to approve a prospectus. Quite apart from any question as to whether this is or is not a correct interpretation of the provisions of the Directive, it is hoped that it will be possible to devise a speedy solution should difficulties actually arise.

55. Rules on Capital Gains Tax are extremely complex, with substantial differences existing between Member States. Even double taxation agreements provide no assurance of equality of treatment between investors. To an extent, this depends on whether gains are treated separately for tax purposes, or aggregated with income for calculating the liability and also whether the State in which the transaction is deemed to have taken place has equivalent treatment rules to those of the home State of the investor. The latter consideration is of particular significance where a pan-European market is concerned.

Ideally, national rules should be framed so that no investors are placed in a worse position than if the shares were sold in their State of establishment or residence. This would effectively require the home State of the investor to allow a full tax credit in respect of the transaction, subsequently making a balancing charge based on domestic fiscal law. This would be particularly important in the case of investors resident in Member States, such as Spain, which have tapering provisions. That is, shares attract a lower rate of capital gains tax the longer they are held before being sold. Whilst competence in this matter lies with the Member States, it is suggested that this matter be given early consideration, with a view to the amendment of existing legislation where this appears appropriate.

56. The methods by which dividends are taxed is another complex subject. Key issues are the level of withholding tax charged by the country in which the company paying the dividend is located (not the country in which the stock exchange operates) and whether the country of the shareholder operates an exemption or a credit system in respect of dividends from extra-territorial sources.

In the short term this is probably a less significant problem than that posed by capital gains tax, as the level of dividends paid by fast growing smaller companies are likely to be low. As they mature, however, it is likely to become more acute. It is suggested that the ultimate objective should be to ensure dividends from a company quoted on a pan-European exchange are treated no less favourably in the hands of investors than dividends from a domestic company. It is believed that this is presently not the case in all jurisdictions.

57. In order to ensure the removal of barriers of the type indicated, an appropriate minimum objective must surely be to ensure that, as implicitly provided for in Article 95 of the Treaty, an investor, when investing in a company from the same Member State listed solely on a stock market located in another Member State, should not be placed in a worse fiscal situation than if the investment was made in their domestic capital market.

In addition, given the importance of developing improved access to equity capital for suitable SMEs, it is hoped that Member States will be prepared to be more ambitious. Specifically by setting out to ensure, through appropriate amendments to their domestic legislation, any stock market transactions made in another country of the European Union by their resident citizens are accorded the same treatment in every respect, including fiscal, as equivalent domestic transactions. In addition, it is hoped they will do all within their power to ensure that citizens and companies from other Member States carrying out similar transactions on their own territory will not be discriminated against.

VII. CONCLUSIONS.

58. The past year has seen a number of potentially significant developments in relation to European stock markets. What is clear is that, given the liberalizing framework provided by Community legislation, major new opportunities have been created, for companies to raise capital, for investors and, for those operating in financial markets.

In the investment field the information society is already becoming a reality, with the electronic market place for share dealing being the norm. Whilst it is impossible to predict the eventual outcome, it is clear that major changes to existing structures will continue, with national boundaries becoming less relevant within a global financial market place. This in turn should create more interest by companies in the advantages of accessing equity capital through securing a listing on a stock exchange and among investors because of the greater range of opportunities available, coupled with improved availability of information. In addition, the growth in private pension provision will substantially increase the level of investment by financial institutions.

At this stage, no one can be totally certain that these new pan-European markets will eventually prove profitable for those who have invested in them. Nevertheless, this is a matter of commercial risk, which investment bankers and other members of the financial community should be best placed to judge. That they have been prepared to launch such an initiative, demonstrates the correctness of the decision by the Commission to endeavour to stimulate the private financial sector to test the feasibility of creating a pan-European stock market for the shares in entrepreneurially managed fast growing companies, as opposed to itself taking the initiative.

That this, together with other developments at the national level, are purely commercial enterprises, does not mean that either the European Commission or the Member States can remain aloof from their development. To do so would be to forget the political objective of this whole exercise, improving the access of Europe's fastest growing smaller firms, some of whom will be among its industrial and commercial champions in the future, to long-term equity capital. This applies with particular force where firms engaged in high technology activities are concerned. The Commission will initiate a broad debate on this question in the Green Book on Innovation currently under preparation.

Whilst the existing corpus of European law, once fully in force, should allow the technical creation of markets with cross-border trading aspirations, enough possible difficulties, particularly for investors, have been identified in Section VI as to threaten to hamper their operations. Whilst it is the duty of the European Commission to act as guardian's of the Treaty and, therefore, to ensure the free movement of capital, it seems clear, in addition, that some of the problems identified, following the principle of subsidiarity, clearly fall within the competence of the Member States.

Given this, and the degree of urgency involved, it would appear desirable to deepen the current cooperation between the European Commission and the Member States in order to devise how best the barriers identified can be reduced, or better still removed. Decisions will have to be taken having regard to particular national legal and fiscal traditions, but it is hoped that the importance of this matter to the future development of many of Europe's most promising companies, wherever located within the Union, will provide a sufficient level of justification to Member States to provide the required impetus for change.

ANNEX A

THE US NASDAQ STOCK MARKET

NASDAQ is a screen-based, quote driven market, without a trading floor. It has been developed as a market focussing specifically on meeting the needs of high growth companies seeking to raise equity capital in order to fund further expansion. It is now the primary market in the USA for companies wishing to raise finance by means of an initial public offering. Out of the "Forbes" magazine list of its 200 best small firms, 154 were listed on NASDAQ. The actual system is operated on a non-profit basis for the benefit of the members of the National Association of Securities Dealers and directly employs 113 persons in running the market. In addition, it should be noted, the USA has a number of regional "over the counter" markets on which approximately 15,000 companies are registered and whose shares are traded.

Figures for 1994 show that, since its foundation on 5th February 1971, NASDAQ has become a major force in stock trading:

Annual share volume (billions)	74.4
Average daily share volume (millions)	295.1
Highest daily volume (millions)	414.0
Dollar volume (billions)	$1449.3
Companies issuing NASDAQ securities	4902
Securities in the NASDAQ market	5761
Market makers in NASDAQ securities	501
Average market makers per security	10.9
Small Order Trades (billions of shares)	1.45

Of the securities listed at the end of 1994, 3,772 were on the National Market and 1,989 on the SmallCap Securities Market. It is now the largest stock market in the world measured by the number of companies listed, the second largest based on the dollar value of equities traded, and the third largest in terms of numbers of shares traded. A total of 445 initial public offerings were made during the year raising $12.24 billion. In addition, 667 companies already listed on NASDAQ made subsequent public offerings of shares, raising a total of $21.1 billion.

TRADING: NASDAQ Level 1 is an on-line system that serves both individual investors and registered representatives. The service provides screen displays of quotations by market makers, details of the last sale and market summary data. NASDAQ only provides the service for use on existing terminals. There are 216,056 linked terminals in the USA and 29,942 terminals in 52 other countries. Of those outside the USA, 10,324 or 34.5% are located within the EU and are distributed as follows:

Austria	308
Belgium	190
Denmark	109
Finland	29
France	895
Germany	2054
Greece	40
Ireland	14
Italy	736
Luxembourg	563
Netherlands	585
Spain	113
Sweden	267
United Kingdom	4421

Canada and Switzerland account for a further 16,752 or 56%, showing that European investors constitute the most significant body of participants outside North America. These figures may provide a reasonable indicator of the proportionate interest within each EU Member State in international share trading.

MARKET MAKERS: are connected by 80,000 miles of leased telephone lines to the central computer complex in Connecticut. The average number making a market in each quoted share (10.9) appears to be one of the strengths of NASDAQ because of the degree of competition and market liquidity this brings (others are reputation, the high price earnings ratios secured by companies listing their shares and an efficient electronic trading system). In 1994 there were 501 market makers. What is impressive, when it is considered that there are a significant number of firms listed on the London exchange with a market value of £50 million (ECU 60 million) who find it difficult to find two market makers willing to deal in their stocks, is how few NASDAQ listed stocks have a small number of market makers:

Less than 3	66
3-5	502
6-10	1404
11-15	990
16-20	417
21-25	189
26 or more	209

As might be expected market makers are largely concentrated in New York, where 205 or 41% are located. Next comes California with 40. Some less populous US States such as Idaho and Maine have only one resident market maker, emphasising the strength of a screen based system that allows the quotes of market makers to be compared wherever they are geographically located. This concentration in two financial centres also tends to illustrate the fact that large institutional investors such as pension funds prefer to deal with large market makers with whom they are transacting business in other fields. This would also be important in relation to any European market that was established.

Where small trades of less than 1,000 shares are concerned, the Small Order Execution System can be used in order to reduce costs. This permits the automatic execution of a customer's order at the best available price shown on the system at the time the order was placed. Through using this system a transaction can be completed in less than one minute.

COMPOSITION OF THE MARKET: by type of company is:

Industrial	3019
Other Financial	646
Bank	320
Insurance	107
Telecommunications	141
Transportation	91
Computer	461
Biotechnology	94
Other	890

Reportedly some twenty per cent can be described as being engaged in high technology sectors of activity. As firms do not have to leave the NASDAQ market unless they wish to do so, some of the firms listed are of considerable size. These include: Apple Computer; Dell Computer; Intel; Lotus Development; MCI Communications; McCormick & Co. (foods); Microsoft; Pacific Telecom; and Sun Microsystems.

EUROPEAN UNION COMPANIES LISTED: As at the end of 1994 the total was believed to be 94 (of which only 12 were on the SmallCap market), broken down as follows:

Denmark	1
Finland	1
France	4
Greece	1
Ireland	9
Luxembourg	4
Netherlands	13
Sweden	8
United Kingdom	53

INVESTORS: of the 11.4 billion shares outstanding at the end of 1994, 53.7% were held by institutions and 46.3% by other investors, including directors. It is difficult to break down the respective degree of institutional activity between mutual funds, pension funds and hedge funds. Large block trades, those over 10,000 shares, accounted for 42.9% of the total annual volume of shares traded. Transactions involving 500 shares or less account for about 25% of the total.

LISTING REQUIREMENTS: To qualify for admission to the NASDAQ National Market firms must:

- register their offering with the Securities and Exchange Commission:

- have a minimum of two independent (non-executive) directors on the board;

- maintain an Audit Committee with a majority of independent directors;

- provide shareholders with annual reports and make quarterly and other reports available to them;

- examine all trades between parties related to the company for potential conflicts of interest;

- hold an annual meeting of shareholders and provide notice of the meeting to the NASD;

- specify in its by-laws (equivalent to memorandum and articles of association) that a quorum of shareholders shall consist of holders of not less than 33.3% of the outstanding ordinary shares;

- invite the lodging of voting proxies and provide statements for all meetings of shareholders, as well as filing the proxy invitations with the NASD;

- secure shareholder approval for certain transactions and any increases in the number of ordinary shares issued;

- refrain from any action to undermine the per share voting rights of any existing class of ordinary shares or any action that nullifies, restricts or reduces those rights;

- execute a NASDAQ listing agreement.

Foreign issuer's of shares may be exempted from compliance with one or more of these conditions should they contravene the law or be against business practice in their country of domicile.

Smaller companies can be listed on the SmallCap Securities Market as opposed to the National Market. Quantitative standards vary according to the type of company involved, but for the common stock of an ordinary domestic company the initial requirements are:

Total Assets	$4 million
Capital and surplus	$2 million
Number of shares offered to public	100,000
Market value of flotation	$1 million
Minimum number of market makers	2
Bid price per share	$3
Shareholders	300

In order to maintain registration the following requirements must be met:

Total Assets	$2 million
Capital and surplus	$1 million
Market value of shares	$200,000
Bid price per share	$1

the other figures remaining unchanged. A quotation may still be maintained if the bid price for the shares falls below $1 providing the shares publicly available have a market value of $1 million and the capital and surplus amounts to $2 million.

ON GOING REPORTING REQUIREMENTS: The market has developed levels of protection against fraud that are equivalent to those of the New York Stock Exchange. Some of the on-going reporting requirements imposed on companies listed on NASDAQ are actually more onerous. In each case, trading results for each quarter must be made public.

MARKET GOVERNANCE: Accusations have been levelled during the past two years that NASDAQ was being insufficiently regulated, leading to market makers benefiting unduly at the expense of investors. In consequence, the NASD Select Committee on Structure and Governance was established, under the chairmanship of ex-Senator Warren B. Rudman, to examine these criticisms and to make such recommendations as were thought fit.

In its Report, published in September of 1995 the Committee stated:

"Based on its Review, the Select Committee concludes that the NASD has discharged its self-regulatory responsibilities, not of course with perfection or without difficulty, but professionally and reasonably." It goes on to state that it "does not support the claims of those who assert that the NASD is controlled by and for the benefit of NASDAQ market makers. Nor does it support those who assert that the NASD cloaks in regulatory garb actions that are in fact designed solely to advance the commercial interests of certain segments of the NASD's membership. The Select Committee does find, however, that the NASD's governance structure has failed to keep pace with the significant growth and continuing evolution of the NASDAQ market, and the concomitant expansion of the NASD's regulatory responsibilities."

As a result various recommendations are made, which it is believed the NASD are inclined to accept, for a clear separation of the tasks of running the operations of the market and regulating it, together with greater external representation on the NASD's governing bodies.

ANNEX B

THE POTENTIAL MARKET FOR COMPANY FLOATATIONS IN EUROPE

1. A recent survey carried out for the Danish Ministry of Industry revealed that some 270 small and medium Danish companies would be interested in listing their shares if a specialized national market for growth companies was established. Of these, eighty would be interested in securing a listing on a pan-European market.

2. In order to obtain information concerning the potential viability of a pan-European stock market for smaller companies, the European Commission organized a study, under the SPRINT programme, to ascertain the number of companies who might float their shares on such a market. This report was received in December of 1994.

Four countries: Spain, the Netherlands, France and the United Kingdom were selected in order to provide a mix of countries with both mature and emerging main and secondary capital markets. A representative sample of venture capitalists and investment bankers in each of these Member States, with direct relationships with firms having the potential to float their shares during the next three years, were contacted. More specifically, they were asked to provide details of companies having the correct profile for a listing on EASDAQ.

Out of the ninety two intermediaries contacted forty eight replied, identifying a total of 475 companies with a potential for floatation on a stock exchange. Of these 230 were stated to meet the profile required for EASDAQ. These companies were located in: France 92, Netherlands 15, Spain 28, United Kingdom 82, other countries 13.

One third of the potential companies were engaged in high technology activities, such as electronics, biotechnology and communications. The remainder were spread over a variety of sectors, ranging from retailing to industrial products and services. The proportion of high technology companies varied widely between countries, from 50% in the United Kingdom and the Netherlands, to 11% in Spain and 29% in France.

Fifty of the companies expected to have a market capitalization of over £50 million. The majority of these larger companies came from the French survey. Conversely, 54% of the companies expected to raise less than £15 million on floatation. Some two thirds of the sample were anticipated to be ready for floatation by the end of 1996, although this must be regarded as optimistic given the amount of preparatory work involved.

The 230 companies identified broadly fell into two categories:

- companies not currently served by national stock markets;

- companies which are floatation candidates on existing national exchanges but are also EASDAQ candidates.

Clearly a pan-European market would only attract the second category if it offered either an international profile, or an opportunity to market shares at a high price/earnings ratio, or both.

Whilst France brought the lowest response rate at 41%, those investment bankers replying were the most positive of all concerning a pan-European market, believing it would help newly created and fast-growing companies whatever their sector or size. It is unlikely that these opinions would be greatly affected by the subsequent announcement of the launch of the French Nouveau Marché, as most would have been aware of the forthcoming announcement of the new market at the time they responded to the survey.

The responses from Spain indicated a great interest by venture capitalists in the creation of a pan-European market. Conversely, no replies were received from investment banks. This is apparently for three main reasons: an unwillingness to disclose confidential information; lack of knowledge of the EASDAQ concept; and, the relatively small portfolio of suitable companies held.

Whilst the concept of a pan-European exchange received a cautious welcome in the Netherlands and the theoretical need was clearly recognised, many financial intermediaries were unsure about the effect it would have on their business. One problem identified was the very limited number of Dutch companies likely to be attractive to international investors.

The United Kingdom attracted the highest response rate of 77%. It was thought by a number of intermediaries, but by no means all, that the majority of smaller British companies were very national in their outlook and could be catered for perfectly well by the London Stock Exchange. However, those with a more European outlook may well come to look to EASDAQ as those with a significant presence in the USA now looked to NASDAQ. Even the more negative respondents said they were not against the concept of a pan-European exchange, merely cautious. Conversely, a number of very positive responses were received.

CONCLUSIONS:

Results from such a partial survey must be treated with caution, but both a significant degree of support for the concept of a pan-European exchange and a sufficiently large number of companies who could be floated on it were identified. Nevertheless, few companies were put forward as candidates without reservations being expressed. In order to attract them, any pan-European market would have to: allow listing at a reasonable cost; attract the interest of investors; be as liquid as the best of current national markets; offer a high level of advice and research; and, meet the needs of entrepreneurial companies not served by existing national markets.

ANNEX C

INVESTOR INTEREST IN A PAN-EUROPEAN STOCK MARKET FOR GROWTH COMPANIES

In order to discover the likely degree of investor interest in the EASDAQ market, an independent survey was carried out,[20] the results being published in June of 1995.

A total of 292 questionnaires were sent out to selected investors in France, the Netherlands, Spain, the United Kingdom, Germany and Italy. These asked for details of institutional or private client funds invested or managed and for an estimate of the percentage of those funds that might be directed towards EASDAQ stocks. Investors with a small company or European focus were selected where possible, but a number of general funds were also included. Ninety nine replies were received and follow-up telephone interviews conducted.

Out of the total funds of £231 billion managed by the respondents, an average of 19% was invested in companies with a market capitalization of less than £100 million. Out of the ninety nine respondents, thirty eight said they were unlikely to invest in EASDAQ, either because they did not have the cross-border capability or, did not invest in smaller companies. The remaining 61 indicated they did envisage investing an average of 3.3% of their funds in EASDAQ stocks.

The latter category were attracted to the EASDAQ concept because it was pan-European and highly regulated. Many said the indicated investment levels were extremely cautious. Were a credible market to be created, which could not be judged at this stage, these could increase markedly. In addition, it is likely, according to the report, that further specialist small company European funds would be created, in the USA as well as Europe, in order to take advantage of this new opportunity.

The initial amount of investment by individuals, at least at first, is likely to be low. Most of those who do, will participate through the medium of managed investment funds.

2. A study, being conducted for the European Capital Markets Institute (of which the Commission is now a member) entitled "Eliminating Barriers to an integrated European Secondary Equity Market" will be released at the end of 1995. Reportedly this is already revealing a rapid development in the number and size of Mutual and SICAV funds within Europe, together with a rapid growth in the volume of cross-border institutional investment.

---

20 by Coopers & Lybrand

CONCLUSIONS:

Whilst considerable interest in a pan-European stock market evidently exists amongst European institutional investors and fund managers, current knowledge of EASDAQ is currently extremely low, which has limited the strength of the response to this survey. For this and similar markets to be successful, a considerable promotional effort will be required as soon as the structures and rules of the markets have been finalized.

29

ISSN 0254-1475

COM(95) 498 final

DOCUMENTS

EN 09 08

Catalogue number : CB-CO-95-539-EN-C

ISBN 92-77-94649-0

Office for Official Publications of the European Communities

L-2985 Luxembourg