EUMEDION
CORPORATE GOVERNANCE FORUM

POSITION PAPER

THE FUTURE OF THE PUBLIC EQUITY MARKET

From the perspective of Dutch institutional investors

Contents

1. Introduction

1. Equity financing through the public capital markets plays a leading role in the economy. Companies need equity capital to invest, to grow and to achieve the returns needed to meet obligations to providers of debt finance. The subsequent results include increased employment opportunities. Equity capital can be used to finance promising projects in research and product innovation for example, even when these will only earn returns in the long term. If investments are successful, the provider of the equity capital is entitled to the returns realized.

2. Given the importance of equity capital in the growth of companies, it is concerning that the Dutch regulated stock market for small and medium-sized companies appears to be declining in importance. There are also concerns about the role and function of public equity markets at wider European and international levels. Eumedion and its members attach great value to well-functioning and accessible public equity markets, in the Netherlands as well. A substantial and constant inflow of quality companies from the pool of private equity and family owned companies is an essential element in this context. Eumedion believes it has a social responsibility to make a constructive contribution to a healthy future for the public equity market for Dutch companies and to facilitate access to growth capital for Dutch companies as a consequence.[1] It is desirable for the members of Eumedion, who are institutional investors with long-term investment horizons, to be able to continue investing in a variety of Dutch listed companies in future. This is the reason why Eumedion has produced this position paper, which has been prepared by a working party consisting of Eumedion members.[2] A draft of the position paper was discussed during a round-table meeting that was also attended by representatives from the Vereniging van Effecten Uitgevende Ondernemingen (VEUO: Association of Securities-Issuing Companies), investment banks, Euronext Amsterdam, the Dutch Vereniging van Participatiemaatschappijen (NVP: Netherlands Venture Capital Association), the Autoriteit Financiële Markten (AFM: Netherlands Authority for the Financial Markets) and De Nederlandsche Bank (DNB: the central bank of the Netherlands).[3]

3. What are the consequences of the contraction of the Dutch public equity market for the opportunities that small and medium-sized Dutch companies have for raising finance? Should institutional investors, such as those who are members of Eumedion, be concerned about this downward trend and, if they should, what possibilities do they see for improvement? Is there a task here for the legislature and public regulatory authority? These and other questions will be considered in this position paper on the changing size and function of the public equity market for Dutch companies.

[1] Their social responsibility has already led Dutch institutional investors to commit themselves to investments in what are, by their nature, illiquid asset classes (mortgages, infrastructure and sustainable energy projects) and in SMEs, to encourage economic growth in the Netherlands. The organizations concerned are the Nederlandse Investerings Instelling (NII: Netherlands Investment Institution) and the related Nationale Hypotheek Instelling (NHI: National Mortgage Institution), the MKB-financieringsfonds (Finance Fund for Small and Medium-sized Enterprises) and the NL Ondernemingsfonds (Dutch Entrepreneurs Fund). Also see the letter of 17 November 2013 from the Netherlands Minister of Economic Affairs (Kamerstukken (Parliamentary Papers) II 2013/14, 33 746, no. 1).

[2] The membership of the working party will be found in Appendix I.

[3] The round-table meeting was held in Amsterdam on 19 May 2014.

2. Summary

<u>The state of the Dutch stock market</u>

4. The function and structure of the Dutch public equity market have undergone major changes in the past ten to fifteen years. While the market formerly fulfilled an important function in financing the growth of smaller domestic listed companies, the present structure of the ecosystem has led to greater emphasis being placed on offering liquidity to larger multinational companies. Connected with this is the gradual decrease in the number of listings of smaller companies in particular in the past ten years, while the secondary offerings from the larger listed companies are successful. The Dutch public equity market is not unique in this respect, however, since similar developments can be observed in other countries in continental Europe.

5. Share ownership in Dutch listed companies has become much more international. Pension funds and other Dutch institutional investors have started investing significantly less in the Dutch stock market over the years. The phasing out of investment restrictions (as from 1996) and the introduction of the euro (1999) were driving forces in this process. The home bias of Dutch institutional investors has decreased more sharply than that of institutional investors based in other European countries. Investment in shares has become much less attractive for insurers with the new Solvency II regulatory regime.

6. A greater variety of opportunities has developed for investing and trading in shares in Dutch listed companies (e.g. derivatives). Shareholders base their investment decisions less on their own analyses of the fundamental value of companies than they used to, and more on benchmarks and analyses made by others (passive investment). Engaged and stable share ownership focused on good governance and sustainable performance is attracting greater interest, but is only being practised on a limited scale as yet.

7. In the case of small and medium-sized companies that *do* need equity capital for growth, however, the public equity market is steadily becoming a less obvious option, specifically when there is little free float and their investment story is a complex one. Investment banks seem somewhat averse to risks and see little business in supporting the flotation (IPO) of a small company with limited liquidity, preferring larger companies. Brokers and analysts are also gradually becoming less able to afford to devote time to analysing and recommending individual companies as long-term investments for their clients. Euronext Amsterdam appears to have a preference for listed companies with high market values.

Structural causes

8. The decline of the Dutch regulated stock market cannot be fully explained by cyclical conditions – strong growth in the number of IPOs is visible in Europe at this moment – but has structural causes affecting both the supply side and the demand side.

Demand side factors *(Less investor demand for public equity in Dutch companies)*

- **More alternatives for shares are becoming available (other asset classes).**
- **Regulatory frameworks that discourage investment in shares (specifically Solvency II).**
- **Many large Dutch institutional investors have chosen to invest both worldwide and on a widely diversified basis in shares of mostly larger listed companies. This is mainly done by following indices.**
- **Alternative institutional investors (sovereign wealth funds, hedge and private equity funds) have become more important, but invest less in shares.**
- **Private investors have reduced the size of their share portfolios.**
- **Institutional investors are not often willing to participate in an IPO. The price, the lack of promptly available information and, in some cases, the absence of the right in-house expertise play a role in this situation.**
- **Banks, brokers and analysts see little business in recommending small and medium-sized listed companies and in facilitating IPOs for companies of that kind.**
- **Ageing populations and changes in pension systems.**

Supply side factors (*Less need for companies to strengthen capital through a public equity market*)

- **Dutch and European companies have a traditionally strong focus on bank financing. Low interest rates and preferential tax treatment for debt finance as opposed to financing by equity capital contribute to this.**
- **The need for fresh equity capital at many Dutch companies with primarily European outlets is less than had been imagined, due in general to good solvency and limited opportunities and ambitions for growth.**
- **In the case of medium-sized unlisted companies that do actually need fresh capital, the public share markets are a much less obvious option than the merger and acquisition route. The diversified share ownership at Dutch listed companies and the increased transparency are regarded as disadvantages.**
- **In the 'pipeline' (family businesses, companies in the hands of private equity) for IPO's of Dutch companies there is definitely no pressure to take the leap and apply for a listing.**
- **The high costs of preparing a stock exchange listing and a certain diffidence concerning the constant attention and transparency.**

Is the decline a problem, and for whom in that case?

Institutional investors

9. Where Dutch institutional investors are concerned, the presence of limited opportunities on the Dutch public equity market in terms of the number of listings does not necessarily constitute a problem in itself. As long as there are enough other options for investing in listed companies with comparable standards of corporate governance and transparency through other regulated markets, Dutch institutional investors are not restricted in their opportunities for meeting their (fiduciary) responsibilities. The position is obviously different for institutional investors who focus specifically on the Dutch public equity market.

10. The unsatisfactory functioning of the Dutch IPO market may, however, indirectly constitute a problem for institutional investors. This happens when the decline is part of a wider international trend, which currently seems to be the case. The investment opportunities for institutional investors are impaired when the public equity markets are less deep and wide.

Dutch companies

11. The unsatisfactory performance of the Dutch IPO market is unfavourable for Dutch companies. Well-functioning public equity markets can be an importance source of long-term finance and the realization of the growth potential that companies have. This is particularly true of medium-sized Dutch companies, for which it is less easy to raise capital on foreign public equity markets. These companies must rely primarily on private equity and the merger and acquisition route for financing growth.

12. An IPO market which is not functioning satisfactorily restricts the opportunities for raising additional equity capital, while share capital/equity capital can give an enterprise a certain resilience during economic downturns. When the Dutch equity market is unable to satisfy companies' intrinsic needs for more equity capital in order to grow, an equity gap develops.[4] This equity gap could lead to smaller companies opting (1) to invest less and grow less or (2) to use more debt finance and less equity capital to finance growth.

Final observations

13. Eumedion concludes that many institutional investors, (potential) listed companies, banks, Euronext Amsterdam and retail investors have clear and rational reasons for not giving preferential treatment to Dutch or European small and medium-sized listed companies on the public equity markets. The resultant of this is, however, that the public equity market is not performing in the best possible way in its function as a source of finance for small and medium-sized Dutch companies and – as a reflection of this – is not offering more opportunities to

[4] European Commission 2013 I.

investors to achieve long-term returns. The importance of the public equity market for the Dutch economy has declined as a consequence.

14. It is assumed that when Dutch institutional investors invest more in the Dutch economy this has a favourable effect on job creation and subsequently also on the capital accumulation and coverage ratio of pension funds and other institutional investors. This assumption appears to apply to initiatives such as the Dutch Investerings Instelling (NII: Dutch Investment Institution) and the related Nationale Hypotheek Instelling (NHI: National Mortgage Institution), the MKB-financieringsfonds (Finance Fund for Small and Medium-sized Companies) and the NL Ondernemingsfonds (Dutch Entrepreneurs Fund). What is less certain is whether the assumption also holds good for the investments made by Dutch institutional investors in listed companies via the Dutch regulated market. This deserves further research. It would appear at present that when stock exchange operators provide specific incentives to improve the climate for small and medium-sized listed companies, this may have a positive effect on the domestic economy, as is shown by the findings of the Organisation for Economic Cooperation and Development (OECD):

Stock markets that provide significant economic incentives to support small companies and associated infrastructure in the aftermarket will create higher rates of capital formation that, in turn, will generate jobs, economic growth and tax receipts.[5]

15. Consideration should be given to enhancing the attractiveness of the public equity market as an alternative source of growth finance for Dutch companies, in addition to private equity and debt finance. This could help to reduce the gap that has developed between private equity financing and public equity financing. Dutch companies with the potential to become small or medium-sized listed companies need to raise growth capital; a regulated equity market may be a suitable platform for meeting their needs and may offer an intrinsically good environment for providing that capital.

16. Eumedion believes it is desirable, therefore, that measures are taken in the following subareas:

I. Information and dialogue
II. Lowering the costs of an IPO
III. More favourable tax treatment
IV. Removal of regulatory barriers
V. Increasing the liquidity of small and medium-sized listed companies
VI. Encouragement of engaged share ownership
VII. More active approach by Euronext Amsterdam and other relevant parties

[5] OECD 2013 I.

These recommendations will be worked out in more detail in section 8.

3. A changing landscape

17. The Dutch regulated equity market appears to have had its heyday some time ago. The number of listings and the trading volume in the mid caps and small caps have decreased gradually over the last ten years. The role of the public equity market in facilitating the growth of Dutch companies has declined significantly. The organization of the Amsterdam stock exchange, which lost its independence in 2000, has become the subject of a trio of mergers and acquisitions.

Box 1: attitudes of parties involved in the Dutch public equity market

	rational attitude towards Dutch public equity market	But also
Institutional investors	▪ Diversification ▪ Benchmark as yardstick/passive investment ▪ Low costs ▪ Interest in small caps is moderate due to costs of monitoring and limited offerings ▪ Not generally adverse to takeovers/delistings of listed companies	▪ Ambition to be engaged long-term shareholders ▪ No efficient market without analysis of companies ▪ Increasingly fewer listed companies
Listed companies	▪ Exchange is potentially attractive alternative for dependence on banks/debt finance ▪ Need for stable shareholders, but these are difficult to find ▪ Fear of hot money ▪ Chance of hostile takeover is a risk ▪ 'Spotlights' are very fierce sometimes ▪ Supervisory burden and bonus regulations are an impediment	▪ Interest must remain low and credit accessible ▪ Listing of Dutch companies with a controlling shareholder (a stable shareholder therefore) on exchanges outside the Netherlands ▪ Share must be sufficiently liquid to absorb unnecessary price fluctuations
Banks	▪ Reticent about underwriting flotation of small caps and "positive offerings" due to 'weak demand and low yields' ▪ Difficult to find institutional investors (lack of single point of contact) ▪ Near equity may be something for the future	▪ Pressure for equity offerings by small and mid caps, if there is a threat of their no longer being able to comply with bank covenants (so is there demand after all?)
Stock exchange	▪ Focused on the bigger (international) listings, due to higher yields and chances of success ▪ Too little of a launching pad present for first corporate bond listing for small caps ▪ Requires liquidity (has an interest in transactions)	▪ Frustration about success of IPO small caps at other Euronext venues
Retail investors	▪ Became risk-averse after World Online ▪ More focused on investment funds, ETFs and deposits	▪ 'Why does my pension fund invest so little in the Netherlands?'
Private equity companies	▪ Exchange is less attractive for shareholders due to compulsory disclosure and less influence on company strategy ▪ Greater influence of PE also means greater willingness to participate in more than one round of financing ▪ Exit of PE preferably in a single operation: merger or acquisition ▪ PE companies Biotech/Health prefer the NASDAQ	▪ More attractive IPO climate provides companies and PE owners with more exit options
AFM/DNB	▪ Netherlands Financial Assessment Framework (FTK) does not stand in the way of the home bias of the Dutch stock market, as long as the entire portfolio complies with the prudent person principle	

18. The function and structure of the Dutch equity market have also undergone major changes. While the market used to fulfil an important function in financing the growth of smaller domestic listed companies, more emphasis is now placed on offering liquidity to larger multinational corporations.[6] The rise of the trade in derivatives from shares, specifically in larger companies, played a role in this respect.

[6] European Commission 2013 I, KPMG 2013, OECD 2013 I, Kay Review 2012.

Furthermore, a wider variety of opportunities developed for trading in shares in Dutch listed companies through alternative electronic platforms (such Chi-X, BATS, Turquoise and TOM MTF)[7] as well as via closed broker-to-broker facilities (broker crossing networks, dark pools).[8] The advent of electronic trading has enabled the automatic placement of orders on the basis of computer algorithms. A specific form of algorithmic trading is high frequency trading in which positions are moved into and out of within fractions of seconds.

19. Pension funds and other Dutch institutional investors have gradually started investing significantly less in the Dutch public equity market and in Dutch listed companies by extension. An important explanation for this is the abolition of the international investment restrictions for Dutch pension funds in the nineteen-nineties. The phasing out of ownership of Dutch equities gathered momentum on 1 January 1999 when the currency risk disappeared within the Eurozone. The importance of Dutch shares in the total equity portfolio of pension funds has gradually been reduced to the importance that the Dutch economy represents in the Eurozone. In 2012 1.3% of the total assets of Dutch institutional investors was invested in shares in Dutch companies, as against 7.3% in 1998. The preference of Dutch investors for domestic shares (home bias) decreased following the introduction of the euro, showing the sharpest fall, incidentally, of all the thirteen euro countries at that time. As far as insurers are concerned, the developed framework of Solvency II has made it less attractive (more expensive) to invest in shares, because they must include a higher risk premium on the balance sheet, which has a negative effect on insurers' investments in the Dutch equity market (figure 1).[9] We will consider this in more detail later in the paper.

Figure 1 Number of substantial controlling interests (more than 5% of the subscribed capital and/or voting rights) held by Dutch pension funds and insurers in Dutch AEX companies

Investor	**20 June 2007**	**20 June 2009**	**20 June 2014**
ING Groep	10	3	5
Fortis/ASR	4	2	3
Aegon	1	1	0
Delta Lloyd	1	3	1

Source: AFM Register Substantial Holdings

20. The distance between capital providers and listed companies has also increased over the years. This is not only because share ownership has become more international, but also because the chain of

[7] In 2012 for example, 61% of the trade in Nutreco shares was conducted via NYSE Euronext and 39% via the alternative trading platforms Chi-X, BATS and Turquoise. The situation was precisely the reverse in 2013: 60.5% of the trade in Nutreco shares was conducted via the alternative trading platforms and 39.5% via NYSE Euronext (Source: Nutreco Annual Reports 2012 and 2013).
[8] KPMG 2013, p 19.
[9] 'Delta Lloyd bouwt belegging in aandelen af', Het Financieele Dagblad of 20 February 2014; "Verzekeraars verkopen massaal aandelen', Het Financieele Dagblad of 9 July 2012.

intermediaries between investors and listed companies has been extended. One reason for this is that investors, specifically Dutch pension funds, have started investing indirectly in the shares in listed companies to an increasing extent (figure 2). The split-up of pension funds and their pension providers in the previous decade, in addition to the rise of investment funds (such as index funds and exchange-traded funds) were important factors in this development.

Figure 2

Balance sheet of Dutch pension funds							
End of year figures in millions of euro							
	2006	2007	2008	2009	2010	2011	2012
Shares and equity interests							
Equity interests in investment institutions	151,567	163,338	148,705	367,680	407,817	438,707	500,313
Total of shares and equity interests	391,686	399,823	293,979	459,768	513,527	530,580	613,508
Equity interests in investment institutions as % of total	**39%**	**41%**	**51%**	**80%**	**79%**	**83%**	**82%**

Source: DNB

21. Although there is a great variety of types of investors and investment strategies, shareholders generally allow themselves to be led less than they used to be by their own analyses of the fundamental values of companies, and more by the benchmark and analyses made by others.[10] They only accept the responsibilities of engaged owners to a limited extent and behave more like the temporary owners of negotiable financial instruments, acting in the spirit of the moment, and this is how they are often viewed by companies. This has been countered by the advent of governance and stewardship codes observed by certain institutional investors who demonstrate more long-term engagement with the day-to-day affairs of listed companies, the quality of the governance structure and the capacity of listed companies for long-term value creation.[11] The European Commission is attempting to give further encouragement to long-term engagement with its recent proposal for amendment of the Shareholder Rights Directive. Little is to be expected in this respect, however, from investors who invest in shares (solely) via derivatives or pursue a short-term strategy (e.g. high frequency traders).

[10] Kay Review 2012, p 39 ff.

[11] See for example the UK Stewardship Code and the Eumedion Best Practices for Engaged Shareholdership.

4. Institutional investors and public equity markets

22. Institutional investors exist in widely varying forms (pension funds, insurers, investment funds and asset managers).[12] They have one aspect in common, however, which is that they invest directly or indirectly at the expense and risk of their ultimate clients, such as pension beneficiaries, employees who pay pension contributions, policyholders, and participants in investment funds. Institutional investors should deal prudently with the resources placed at their disposal, in order to achieve sustainable long-term returns.

23. It is of paramount importance to them, therefore, to serve the interests of the ultimate beneficiaries (referred to as fiduciary responsibility in the case of pension funds). Institutional investors are regularly called on, however, to serve other objectives with their investments. There has been a substantial increase in such appeals in recent years in particular, when the financing of long-term investment projects by banks and governments declined significantly.

24. In order to achieve their (fiduciary) objectives, institutional investors invest in a wide range of asset classes, which differ hugely from each other as regards their nature, liquidity and risk-return ratio. The nature of the obligations (scale, duration), the investment philosophy, the structure of the portfolio and the regulatory framework that applies also define the asset classes in which investments are made and with what degree of diversity. Equities have traditionally been an important class of assets for Dutch institutional investors (26% of the total assets of Dutch institutional investors in 2012).[13]

25. Shares in listed companies are attractive for institutional investors on account of their relatively high liquidity in comparison with shares in unlisted companies and with some other asset classes. Listed companies also have a diversified shareholder base in comparison with other companies (less dominance by major shareholders), good corporate governance (in general) and above-average transparency. Furthermore, institutional investors in various markets have achieved higher long-term returns by investing in equities than they have with bonds and deposits.[14]

26. While listed shares are important for institutional investors, we see vice versa that institutional investors are vitally important for the functioning of public equity markets. In the case of the Dutch public equity market, we see that in 2010 the foreign institutions (mostly institutional investors) and the Dutch institutional investors combined held 84% of the shares, while that amount was still 61% for these two groups together in 1995 (figure 3). The equity interest held by private investors has decreased from 19% in 1995 to a mere 5% in 2010.

[12] S. Celik and M. Isaksson, 'Institutional Investors as Owners. Who are they and what do they do?', OECD Corporate Governance Working Paper no. 11, November 2013.
[13] CBS (Statistics Nederland).
[14] Global Investor Return Yearbook 2014, McKinsey 2011

Figure 3 Shareholder structure of the 25 largest Dutch listed companies (AEX)

	1995	2010
Foreign institutions	37	76
Dutch institutional investors	24	8
Dutch non-financial companies	19	11
Dutch retail investors	19	5
Government	0	0
Unknown	1	0

Source: Eumedion

Less relevant

27. This does not alter the fact, however, that the Dutch stock market has become less relevant, at least where Dutch institutional investors are concerned. Pension funds and other institutional investors no longer seem to have such a pronounced preference for the Dutch market that they are inclined to invest a disproportionately large volume of their invested capital in the Netherlands (home bias).[15] This used to be different. Until 1996 the ABP (the biggest Dutch pension fund) for example, was subject to a wide range of investment restrictions, by virtue of which it was almost only allowed to invest in Dutch shares in practice. They also had little to gain from extensive international diversification in other respects. Low inflation and an attractive return on their equity interests, combined with the Dutch guilder as one of the strongest currencies in the world, were important factors in creating this situation.[16] Dutch pension funds bought large volumes of foreign equities after the abolition of the investment restrictions, at the expense of owning Dutch shares.

28. The introduction of the euro in 1999 resulted in a significant decrease in investments in Dutch listed companies by Dutch institutional investors. Non-Dutch listed companies represented a lower portfolio risk, because the currency risk disappeared within the Eurozone and European financial markets were able to integrate more.[17] The decline of the home bias due to the introduction of the euro amounted to 21% in the Netherlands in 2001, two years after the introduction of the central currency, and climbed to 33% five years after its introduction (2004). The home bias consequently decreased more in the Netherlands than in any of the other twelve euro countries at that time (see figure 4).

[15] Coeurdacier & Rey 2011.
[16] Wilcox & Cavaglia 1997.
[17] Rubbanyi 2013, Fratzscher 2002.

Figure 4 Percentage of domestic equity interests before and after the introduction of the euro (1999)

	1997	2001	2004	Δ97-01	Δ97-04
Austria	82%	49%	68%	-0.33	-0.14
Belgium	86%	73%	69%	-0.13	-0.17
Denmark	83%	65%	74%	-0.18	-0.09
Finland	96%	86%	75%	-0.10	-0.21
France	90%	85%	79%	-0.05	-0.11
Germany	83%	77%	77%	-0.06	-0.06
Greece	99%	99%	97%	-0.00	-0.02
Italy	89%	80%	85%	-0.09	-0.04
Netherlands	**77%**	**56%**	**43%**	**-0.21**	**-0.33**
Portugal	94%	89%	85%	-0.06	-0.10
Spain	95%	89%	93%	-0.06	-0.02
Sweden	86%	70%	73%	-0.16	-0.13
United Kingdom	84%	80%	80%	-0.04	-0.04
United States	83%	82%	81%	0.01	-0.02

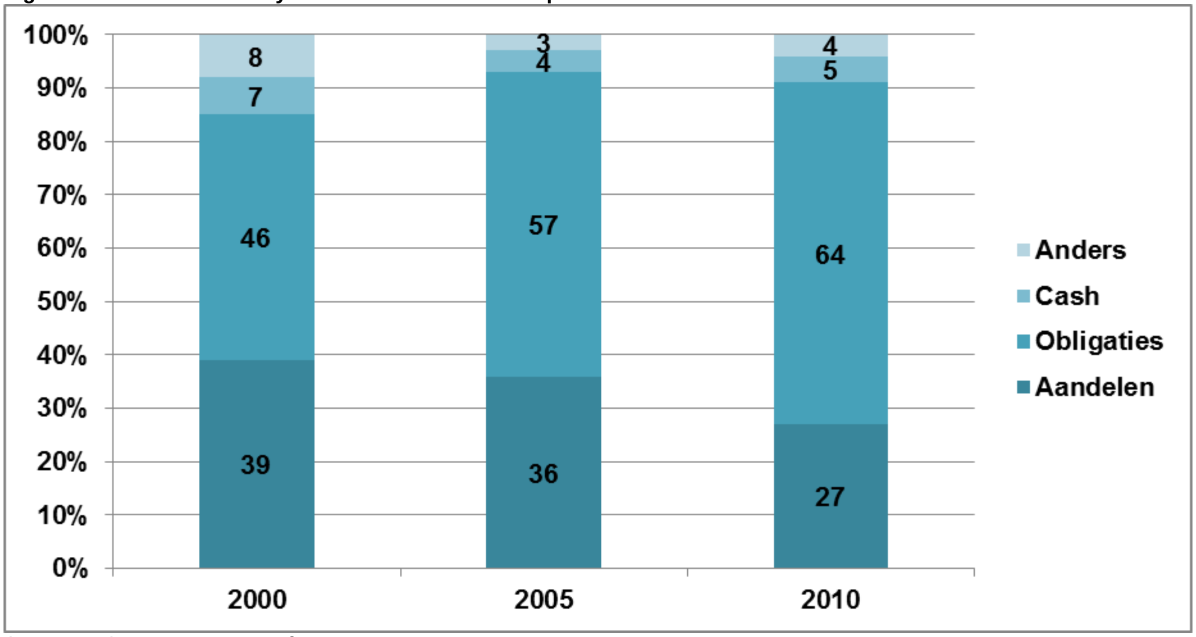
Source: Schoenmaker & Bosch

29. One of the explanations for this stronger decrease is the relatively large size of Dutch institutional investors, specifically pension funds, in relation to the width and depth of the Dutch equity market. In view of the total volume of their portfolios, bigger institutional investors did not achieve much with equity interests in domestic companies. In addition, major institutional investors can easily overcome the barriers associated with international diversification (higher transaction costs and more complex management), partly by economies of scale, so that – given the lower portfolio risk - their returns on a diversified portfolio are higher than for smaller investors (higher risk-adjusted expected returns).[18] In other words: the greater size of the portfolio of the institutional investor has a negative effect on domestic investments. Cultural aspects probably also play a role in the degree of home bias.

30. Insurers have also been investing less in shares in Dutch listed companies since the beginning of this century. Under the new Solvency II regime insurers must, in principle, hold a 39% capital charge for owning shares in listed companies in the developed markets and a capital charge of 49% for other categories of shares. Depending on the (exceptional) development of share prices, the regulatory authority has the power to adjust this capital requirement upwards or downwards by no more than 10%.[19] A capital charge of 22% applies to participations of a strategic nature. Debt-related instruments are potentially less expensive and they are subject to a capital charge of 15%. There is no capital charge whatsoever for treasury bonds issued by Eurozone Member States. Since insurers and possibly regulatory authorities as well are already anticipating the new rules, insurers are in the process of disposing of a significant volume of the equity investments that they hold at their own expense. Some insurers have completely stopped investing in equities (figures 1 and 5).[20]

[18] Rubbanyi p. 28.
[19] Article 106 Solvency II Directive.
[20] Verbond van Verzekeraars (Dutch Association of Insurers) 2013.

Figure 5 Asset allocation by insurers in Western Europe



Source: ECB, Eurostat, McKinsey

Anders: Other
Obligaties: Bonds
Aandelen: Equities

31. In terms of taxation, 5% interests in Dutch listed companies were relatively attractive for insurers for a long time. This advantage lapsed, however, after the establishment in progressive stages of equal treatment for foreign companies and Dutch companies under the participation exemption from taxation, partly under the influence of European law.[21]

[21] On 18 September 2003 the European Court of Justice decided that the limitation included in the 1969 Corporation Tax Act (NL) i.e. that expenses on the grounds of the participation exemption are not deductible if they are not instrumental in making taxable profits in the Netherlands, violated the right to freedom of establishment (the Bosal decision). In the Tax Plan 2004 Dutch legislation was brought into line with this decision (Stb [Bulletin of Acts and Decrees] 2004, 518). In 2007 (Working on Profit Act) the conditions for eligibility for application of the participation exemption were fully equated for interests in Dutch and foreign companies (Stb, 2006, 631). The requirement that had applied until then that >5% foreign equity interests had to be demonstrated not to be investments lapsed. This meant a further substantial easing of the participation exemption with regard to interests in foreign subsidiaries.

5. The state of the Dutch public equity market

Declining number of stock exchange listings

32. The role of the Dutch regulated market in the facilitation of the growth of Dutch listed companies has shrunk in the past decade. Between 2003 and the end of 2013 thirty-four new listings (initial public offerings or IPOs) for Dutch companies took place, with which only € 20 billion of fresh capital was raised (KPMG 2013). The number of Dutch listed companies has decreased significantly because a greater number of delistings took place in each year (figure 6).

Figure 6 Number of Dutch listed companies on Euronext Amsterdam in absolute numbers in the period 2003-2013

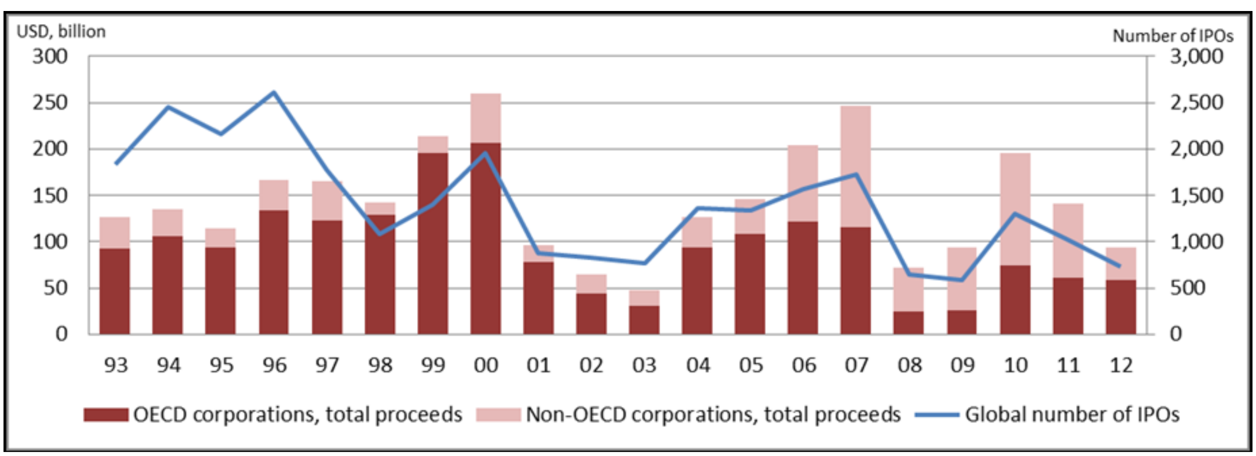
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Dutch companies Amsterdam - total	160	150	143	139	134	121	118	110	105	102	97
Euronext Amsterdam (Dutch companies)	**160**	**150**	**143**	**137**	**132**	**119**	**116**	**108**	**103**	**100**	**96**
Listed public limited companies - Alternext Amsterdam	0	0	0	2	2	2	2	2	2	2	1

Source: Bootsma & Hijink 2014

Worldwide and European IPOs also show a downward trend

33. The decreasing number of listings on Euronext Amsterdam is part of an international trend. Only a third of the number of IPOs take place on an annual basis worldwide than took place in the nineteen-nineties. While more than 2000 IPOs were still taking place on an annual basis worldwide in the nineteen-nineties, this number was only 750 in 2012 (OECD 2013 I; figure 7). The amount of equity raised by the IPOs has also declined. It should be noted, however, that there appears to be a surge in the number of IPOs in 2013 and 2014.

Figure 7 IPOs worldwide (number and proceeds)

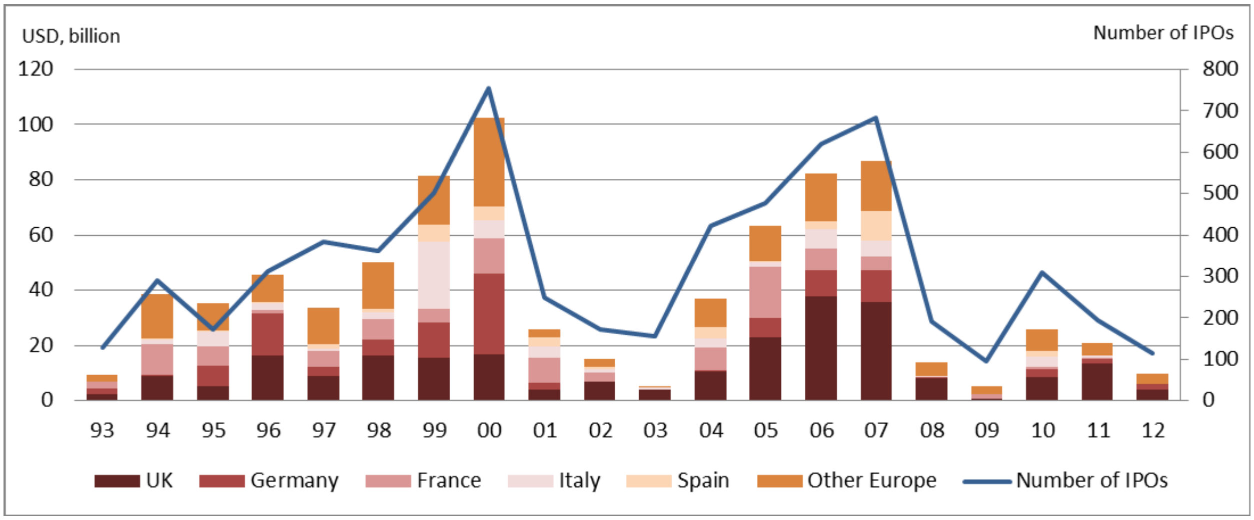


Source: OECD

The results from the European regulated markets are even more negative (figure 8). European Issuers, the European Private Equity and Venture Capital Association (EVCA) and the Federation of European

Securities Exchanges (FESE) set up an IPO Task Force in 2014, which must produce proposals for the European Commission and the European Parliament to reverse this downward trend.[22]

Figure 8 IPOs in Europe: number and proceeds



Source: OECD

Power to attract domestic economy in comparison with other markets

34. We will discuss in more detail the power of Euronext Amsterdam to attract domestic Dutch companies in comparison with the power of other regulated markets to attract domestic companies. It is generally assumed by economists that the number of IPOs from domestic companies should be in proportion to the size of the economy (efficiency ratio).

[22] European Commission 2014.

Figure 9 Number of IPOs in relation to a country's GDP

Country (ranked by 'Domestic IPO efficiency*')	Efficiency Ratio* (IPOs per $100 Billion USD of GDP)[23]	Small IPO's (below 50 million USD)	Large IPO's (above 50 million USD)	Total number of IPOs 2008-2012
Hong Kong	*29.9*	58	16	74
Singapore	*24.4*	62	12	74
Poland	*14.5*	403	18	421
Australia	*13.6*	306	21	327
Israel	*10.4*	22	1	23
Turkey	*6.3*	41	9	50
Canada	*5.2*	513	36	549
United Kingdom	*3.8*	80	41	121
Norway	*3.6*	8	12	20
United States	*2.6*	58	323	381
France	*1.3*	1	34	76
Netherlands	***0.9***	**0**	**7**	**7**[24]
Italy	*0.9*	16	7	23
Germany	*0.8*	18	4	30
Spain	*0.8*	18	4	22

Source: OECD 2013 I, Euronext Factbook, FESE

35. The efficiency ratio of Euronext Amsterdam was significantly lower in the period 2008-2012 than that of regulated markets in the United Kingdom, the United States and Hong Kong, and was similar to that of various other markets in continental Europe (figure 9). In relation to the other regulated markets in continental Europe, the regulated market in Amsterdam achieved an average efficiency ratio in the years 2008-2012. It should be noted that there were also eight IPOs from foreign companies on the Amsterdam regulated market in addition to the seven IPOs from Dutch companies, which brought the total number of IPOs to fifteen in the period in question.

36. The downward trend in stock exchange listings is expected to continue worldwide. Expectations are that only 22% of global financial assets will consist of shares in listed companies in 2020, compared with 28% in 2010.[25]

Important in recapitalization

37. In contrast with the decline in the number of listings, the Amsterdam regulated market has played an important role in the capital reinforcement of existing listed companies (secondary offerings), specifically since the outbreak of the financial crisis. In the period 2009-2013 for example, € 30.2 billion in capital was

[23] These figures exclude very small IPOs with a market value of less than $ 5 million.
[24] The companies involved are Cryo-Save Group and Delta Lloyd N.V. (2009), LBI International N.V. (2010), TNT Express N.V. (2011), D.E Master Blenders 1753, Ziggo N.V. and Core Laboratories N.V. (2012).
[25] McKinsey 2011.

raised by thirty-six Dutch listed companies; € 7.6 billion of this by ING and € 3 billion by KPN (CBS [Statistics Netherlands] 2013). Also worth mentioning is the rights offering from SBM Offshore in April 2012, which was underwritten by new shareholder HAL Investments and raised € 190 million.[26] Engaged long-term shareholders often play an important role in secondary offerings. Secondary offerings with the objective of attracting fresh capital in order to make investments or acquisitions ("positive offerings"), such as that by Boskalis in 2013, only take place very infrequently, however.

Foreign listings in the Netherlands

38. Furthermore, it is clear that Euronext Amsterdam is relatively attractive as the primary listing for companies registered outside the Netherlands. In terms of market value, 10% of the companies listed in Amsterdam have their registered offices in other countries, which puts Euronext Amsterdam in third place on a global level (figure 10).

Figure 10 Foreign principal listings in markets as % of total as at 31 January 2014

Location		
1	57%	HONG KONG
2	20%	SINGAPORE
3	**10%**	**NETHERLANDS**
4	5%	BELGIUM
5	4%	ITALY
6	4%	FRANCE
7	3%	NORWAY
8	3%	UNITED STATES
9	2%	UNITED KINGDOM
10	2%	SWEDEN
11	2%	PORTUGAL
12	1%	POLAND
13	1%	CZECH REPUBLIC
14	1%	TAIWAN
15	1%	GERMANY

Source: FactSet

A recent example is cable company Altice SA, which has its registered office in Luxemburg and has had its principal listing in Amsterdam since 31 January 2014.

Number of Dutch listings in other countries has increased

39. The declining number of listings on Euronext Amsterdam is also put into perspective by the rise, during the same period, in the number of Dutch companies (companies with their registered offices in the Netherlands) with a listing on a regulated market or alternative trading platform in a foreign country (figure 11).

[26] Presentation by SBM Offshore CFO Van Rossum at the 2013 Eumedion Conference.

Figure 11 Number of Dutch listed NVs (public limited companies) with a foreign listing in absolute numbers in the period 2003-2013

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Listed NVs on foreign regulated markets	**20**	**23**	**26**	**32**	**34**	**34**	**33**	**37**	**39**	**38**	**36**

Source: Hijink & Bootsma 2014

In comparison with the twenty Dutch companies with a listing on a foreign regulated market at year-end 2003, this number was thirty-six at year-end 2013 (increase 80%). A slight downward trend appears to have set in here as well, since the peak in 2011 (39 companies). An overview of the biggest Dutch companies with a foreign listing is shown in figure 12.

Figure 12 Overview of biggest Dutch companies with a foreign listing

Biggest Dutch companies with foreign primary listing	Market cap as at 31 Jan 2014 (€ bn)	Primary listing
Airbus Group NV	42	FRANCE
LyondellBasell Industries NV	31	UNITED STATES
CNH Industrial NV	15	UNITED STATES
Nielsen Holdings N.V.	12	UNITED STATES
NXP Semiconductors NV	9	UNITED STATES
Core Laboratories NV	6	UNITED STATES
Chicago Bridge & Iron Co. NV	6	UNITED STATES
STMicroelectronics NV	5	FRANCE
Sensata Technologies Holding NV	5	UNITED STATES
QIAGEN NV	4	GERMANY
AerCap Holdings NV	3	UNITED STATES
Frank's International NV	3	UNITED STATES

Source: FactSet

40. It is also interesting to note that the share ownership in Dutch companies with a foreign listing is much more concentrated than in Dutch companies listed in Amsterdam (figure 13).

Figure 13 Shareholder structure Dutch companies

Biggest shareholder	Dutch companies with foreign primary listing (2012)	AEX Companies[27] (2013)
> 30%	68%	14%
10-30%	19%	48%
<10%	13%	38%

Source: Eumedion, Hijink & Bootsma 2014

It should be noted in conjunction with these figures that Dutch companies with a foreign listing have a lower free float and a higher percentage of dependent supervisory directors (supervisory directors associated with a shareholder).[28]

[27] With the exception of trust offices.
[28] Bootsma & Hijink.

41. All Dutch listed companies with a foreign listing jointly represent a market value well in excess of € 200 billion.[29] If we compare the foreign primary listings of Dutch companies with other countries, we see that, in terms of market value, 29% of Dutch listed companies have their primary listing outside the Netherlands, putting the Netherlands in second place after China, where 44% of the listed companies – in terms of market capitalization – have their primary listing outside China (figure 14).

Figure 14 Primary listings in foreign countries in % market value as at 31 January 2014

Location		
1	44%	CHINA
2	**29%**	**NETHERLANDS**
3	22%	ARGENTINA
4	17%	ISRAEL
5	16%	IRELAND
6	11%	PERU
7	11%	GREECE
8	7%	RUSSIA
9	6%	HONG KONG
10	4%	SINGAPORE
11	4%	ITALY
12	3%	AUSTRIA
13	3%	THAILAND
14	2%	UNITED ARAB EMIRATES
15	2%	MEXICO

42. This indicates that the Netherlands offers attractive legal and tax conditions to foreign companies. Conversely it could also indicate that, where *domestic* companies are concerned, the conditions for a primary listing on Euronext Amsterdam are relatively unattractive in comparison with other markets, in particular for companies with a major shareholder.

[29] At the end of January 2014, Unilever NV with almost € 85 billion had the greatest market value of all Dutch NVs (NV: public limited company) on Euronext Amsterdam. Royal Dutch Shell is formally a foreign company.

6. Causes of the downward trend

43. Various causes can be put forward for the declining interest in new stock exchange listings for small and medium-sized companies. A distinction can be made in this context between factors relating to the demand side and those relating to the supply side. We will explain these briefly below.

Demand side *Less investor demand for public equity*

44. Investments in public equity by the *traditional* institutional investors (pension funds, insurers and investment funds) have proved to have decreased significantly in western economies in the past two decades, as compared with other asset classes. This global decline in the period 2000-2011 was 22% for insurers, 14.4% for pension funds and 7% for asset managers.[30]

45. The reduced interest in shares is connected to the increasing availability of alternative asset classes, such as private equity, real estate, infrastructure and commodities, as well as the greater diversity of investment funds. It is also claimed that various categories of investors believe the stock market is more risky due to the increased volatility of the market in the past few decades.[31]

46. Pension funds and some other institutional investors are increasingly following indices or using indices as benchmarks for their equity investments. If a company is not a component of one of the indices used, which is more likely to be the case for small or medium-sized listed companies than for large caps, then this company is not invested in. Partly due to the greater emphasis on passive indexed investing, pension funds and pension providers are less able (in-house expertise has sometimes been scrapped) and willing to participate in an IPO than they used to be.

47. IPOs are sometimes also less attractive for institutional investors due to their lack of knowledge about the new listed company. It is widely known that an IPO commences with the publication of a prospectus approved by the regulatory authority. In the preceding closed phase the company, its sponsor and other advisers should approach a group of leading institutional investors to provide them with information and to gain their interest in the share to be listed. These institutional investors often require details of the management, the strategy, the market position, the customer base and the results in previous years. They are provided with information during road shows and presentations and sometimes on the basis of reports and a preliminary version of the prospectus. In practice this information does not always prove to be sufficient to meet the investors' requirements, while there is often little time after the launch of the IPO for institutional investors to obtain more detailed knowledge. It is of major importance for the success of the IPO, however, that the information asymmetry to the detriment of investors is addressed.[32]

48. Another factor that contributed to the decline in interest is that, following the dramatic IPO of WorldOnline in March 2000, retail investors became much more reticent about buying shares directly in

[30]OECD 2013 II. Investments in public equity did increase in absolute terms, however, by about 5% (source: OECD 2013 II).
[31] KPMG 2013, Kay 2012, McKinsey 2011.
[32] See ABI 2013.

Dutch small caps and mid caps. They are increasingly investing through investment funds and exchange-traded funds (ETFs or index trackers) or they are leaving a greater part of their assets in deposits, as is shown by data from DNB and other sources for the period 2010-2013.[33] There are three reasons why this development is so important for the Dutch equity market. In the first place, retail investors invest with a strong home bias. Of the € 30 billion that they had invested in equities in 2013, € 20 billion had been issued by Dutch companies. In the second place, private investors are an important factor in price-setting. And finally, retail investors are important for small cap and mid cap companies, because they do not have the same liquidity needs as some institutional investors.[34]

49. Partly because institutional investors and retail investors started to show less interest in Dutch small and medium-sized listed companies, banks have seen less reason from a commercial perspective to recommend small cap or mid cap companies and to facilitate IPO of companies of that kind.

50. The make-up of the Dutch financiers community may also play a role. This group is dominated by larger institutional investors, who use a sizeable part of their capital to finance foreign companies. Corporate finance provided by family offices for example, who invest their entire capital in domestic companies, is relatively rare in the Netherlands,[35] although there are signs that this situation is changing to a certain extent.[36]

51. The ageing population (investors have less need of long term financial instruments when they start to reach pensionable age) and the change in pension systems (from defined benefit to defined contribution) may also have a negative impact on the inclination of traditional institutional investors to invest in the Dutch public equity markets. In defined contribution systems significantly less is invested in public equity on average than in defined benefit systems, because less pension contribution is raised and relatively more is invested in fixed-income securities.[37]

52. The decline in demand is also connected to the fact that the European regulatory framework for certain institutional investors would appear to discourage investments in public equity. This is true of Solvency II in particular, which applies to insurers.[38] Solvency II means that the required solvency margin is limited if no tradable securities, such as shares, are included in the strategic asset allocation. In its present form, the financial assessment framework that applies in the Netherlands to the solvency of pension funds stipulates no specific restrictions on investing in listed companies, not even when such investment is concentrated in the Netherlands, provided that the prudent person principle is complied

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[33] DNB 2013.
[34] OECD 2013 I/
[35] Expertgroep bedrijfsfinanciering 2011 (Expert Group Corporate Finance).
[36] Het Financieele Dagblad, 'Rijke families trekken de portemonnee', 21 May 2014.
[37] McKinsey 2011.
[38] Verbond van Verzekeraars 2013 (Dutch Association of Insurers).

with, which requires that the liquidity risk and the concentration risk are among the factors to be taken into account.[39]

53. Pension funds and their pension providers nevertheless experience obstacles to their ability to make concentrated investments in shares in Dutch companies. This might be explained by the fact that DNB might construe a one-sided focus on return in the investment policy as being in conflict with the transparency standard of the prudent person principle, as a consequence of investments being predominantly made in equities or another asset categories.[40] Many institutional investors have themselves chosen to make widely diversified investments in equities without being required to do so by the rules or the regulatory authority. There are also pension funds and asset managers, however, who have opted for an investment policy whose key element is concentrated investment in shares in Dutch companies, with due observance of the regulatory framework that applies. It should be noted that the financial assessment framework in the Netherlands is to be changed within the foreseeable future.[41] The implications that the changes envisaged will have for the prudent person principle are uncertain as yet.

54. Institutional investors are reticent about investing in and/or are inclined to disinvest in listed companies, when the company does not pursue a clear and robust distribution policy (dividend, investments and purchase of own shares) that is logically consistent with company strategy and is focused on forging long-term ties with shareholders. Long-term investors should understand how a company keeps a balance between dividend payments, purchasing own shares and retaining profits for making investments or maintaining the level of the capital base. Dividend remains an important signal to investors that the company management is confident and it is viewed as an indicator of sustainable profitability.

55. Interest rate movements, which have been showing a downward trend over a period of years, are naturally also able to influence investor demand for public equity. Low interest rates in themselves will not lead to an influx of cash into the regulated market, but the *direction* in which interest rates move may be just as decisive as the absolute interest rate itself, however, because this direction can induce investors to adjust their investment strategies. A rising rate of interest for example, will result in a drop in the value of bond portfolios, so that investors will again start to focus more on other asset classes, including public equity (OECD 2013 l).

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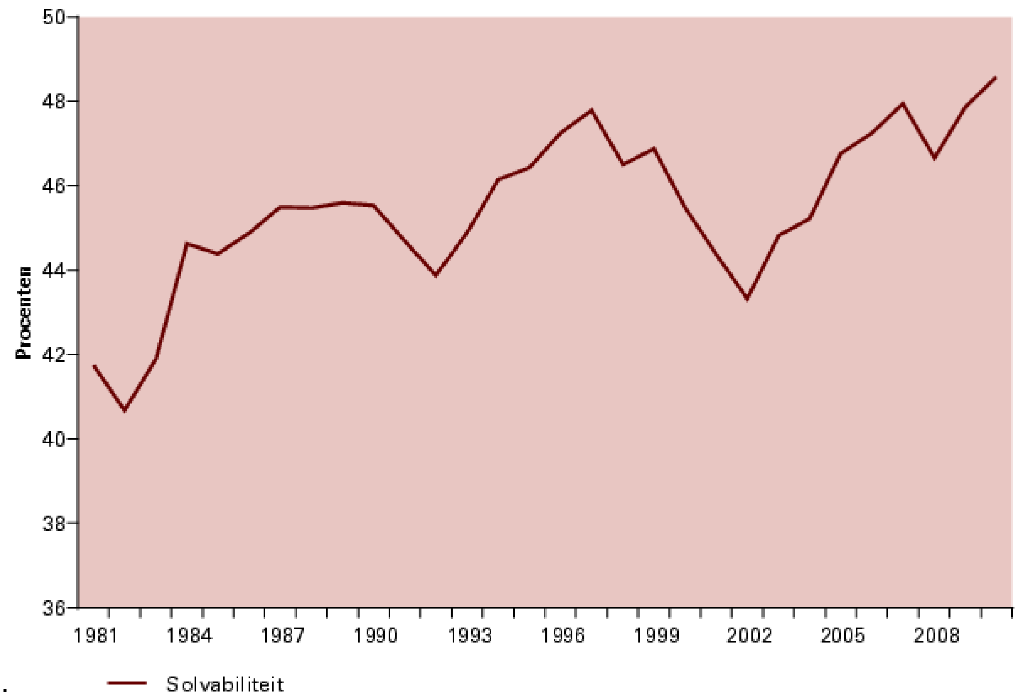
[39] Section 12, paragraph 1 of the Besluit financieel toetsingskader pensioenfondsen (Pension Funds (Financial Assessment Framework) Decree) in conjunction with section 24 of the Pensioenwet en Wet verplichte beroepspensioenregeling (Pension Act and Occupational Pension Scheme (Obligatory Membership) Act).
[40] Section 135 Pensioenwet (Pension Act) and section 13 Besluit financieel toetsingskader pensioenfondsen (Pension Funds (Financial Assessment Framework) Decree); also see Rechtbank Rotterdam, 25 April 2013, Pension Fund Johnson & Johnson Nederland/DNB, JOR 2013/178.
[41] Letter of 4 April 2014 from the Netherlands State Secretary for Social Affairs and Employment on the subject of sending the legislative proposals for the Financial Assessment Framework to the Council of State (NL) for advice (Kamerstukken II 2013/14, 32043, no. 205).

Supply side*: Companies have a limited need for capital reinforcement via public equity markets*.

56. On the supply side, the structure of the Dutch business sector itself may be a constraint. Just like companies in many other continental European companies, Dutch companies have a traditionally strong focus on bank financing[42] and low interest rates have contributed to this. American companies on the other hand, rely much more on market financing via the direct issue of bonds or shares (*market-based system).* The mechanism of the two-stage rocket of a listing on the regulated market for corporate bonds first, then followed by shares does not occur very often in the Netherlands, also in comparison with some other European countries. This existing structure means that the step to a quotation on the stock market represents a huge leap for a Dutch company.

57. Although Dutch and European companies have relatively little equity capital and more (due and payable) liabilities in comparison with American companies,[43] it may be that the need for fresh equity capital at a number of Dutch companies is not as great as has been assumed by some. Not only is the solvency of the Dutch business sector at a relatively high level following a slight decline at the start of the crisis, but many companies are easily able to meet their obligations in the longer term as well (figure 15). The question arises of whether there are as many ambitions and opportunities for growth at Dutch companies that are mainly dependent on the European market. Reinforcement of the equity capital does not appear equally necessary for all Dutch companies therefore.

Figure 15 Solvency ratio of the Dutch business sector



Source: CBS

[42] ASC-ESRB 2014.
[43] EFRAG 2013, p. 14.

58. In the case of small and medium-sized companies that do need share capital for growth, however, the public equity market is becoming an increasingly less common option, specifically when there is little free float and the investment story is a complex one. Investment banks see little business in facilitating the IPO of a small company with limited liquidity through research, trading and sales support, preferring larger companies instead. Brokers and analysts are also becoming less able to afford to devote time to recommending individual companies as long-term investments for their clients.[44] Furthermore, the operator of the regulated market itself does not always show much interest in IPOs for companies with a modest market value.[45]

59. Private companies for which a listing is a future option, view the diversified share ownership of Dutch companies as a disadvantage. They have the idea that many of those shareholders have a short-term focus and will be inclined to quickly dispose of their shares if things are a little difficult for a while. What is needed is a few stable shareholders with a significant equity interest who are prepared to maintain that interest for a longer period. At the same time, it is also considered important for the share to have sufficient liquidity.

60. This liquidity does not always exist, however, for small cap and mid cap firms. Although it is true that there has been a considerable increase in the number of transactions on the Dutch stock market over time, this is not something from which small listed companies have derived much benefit.[46] Lower liquidity for smaller listed companies makes these companies less attractive for investors and there is a further decline in liquidity and in the number of listings as a consequence.[47]

61. In conjunction with this, the pool of IPO candidates among Dutch private companies is rather small. There are few family or private equity owned companies where the existing shareholders are prepared to make their exit and who consider a listing is a real option. Even when a company owned by private equity has the potential of a small cap, the existing shareholders frequently opt for a merger or acquisition transaction, as this enables them to dispose of their shares all at once. Furthermore, private equity companies can frequently afford to wait patiently for returns on investment. They are often able to participate in several rounds of financing, even when no profits are being distributed.

62. The complexity and costs of an IPO also play a role, in addition to the consequences for the AO/IC of the organization. Many smaller companies and their venture capital and private equity investors seem to believe that the merger and acquisition route is their sole option for the next phase of growth. A better bridge from private to public equity in the form of an accessible and vibrant IPO market could represent a good alternative for smaller companies and could strengthen their negotiating position vis-à-vis possible buyers or merger partners. When a small cap has a number of stable, large (>5%) and engaged shareholders, this can mitigate the disadvantages of potentially less liquidity.

[44] (OECD 2013 I).
[45] Speech Cees Vermaas, CEO NYSE Euronext Amsterdam, Eumedion Conference, 8 November 2013.
[46] Kay 2012.
[47] KPMG 2013.

63. When companies in the hands of private equity do decide in favour of an IPO, however, they sometimes do not opt for Euronext Amsterdam, but choose another regulated market instead, because more of their industry peers are active there and/or the company expects to be better valued by investors there (*health science, biotech*). This latter consideration appears to have been important for UniQure, NXP and Prosensa, whose shares have been admitted to trading on the NASDAQ.

64. The costs of a listing and the preferential tax treatment given to debt finance as compared with equity capital are considered to be constraints.[48] Preferential tax treatment combined with low interest rates makes debt finance relatively more attractive than finance with equity capital. These companies might well reach different conclusions on financing their growth if the preferential tax treatment were to be limited and/or interest rates were to rise a little.

65. The costs of an IPO for a small cap amount to an estimated 8.7% of the capital raised.[49] The costs mainly consist of underwriting fees for banks and advisers' fees (accountants, merchant bankers and lawyers) and the listing fee for Euronext Amsterdam. Although these costs may not be excessive on the Amsterdam stock market in comparison with other markets, these are substantial amounts that may form an obstacle to access to a regulated stock market.[50] The cost level increases the chance of a mismatch between the capital costs of listed companies and the returns anticipated by shareholders.[51]

66. Despite the European Commission's attempts to strongly promote the SME Growth Market, this concept has not proved attractive to Dutch companies as yet.[52] It was recently announced that Alternext Amsterdam will be closed.[53] The supply side and the demand side in the Netherlands would appear to have a greater preference for the regulated market. The NPEX exchange for SMEs may possibly be a positive exception in this respect.

[48] European Commission 2013 II, p. 19.
[49] KPMG 2013.
[50] ESMA SMSG 2012, European Issuers 2012.
[51] ABI 2013, Kay review 2012.
[52] European Commission 2014 I, Art 39 MiFID II.
[53] Press release NYSE Euronext, 9 April 2014,'Euronext to wind down Alternext Amsterdam'.

7. Is the decline a problem?

67. One question that can be asked is whether the decline of the interest in and the contraction of the public equity market in terms of the number of listings for Dutch companies may constitute a problem for the Dutch economy and institutional investors in particular.

Institutional investors

68. Where Dutch institutional investors are concerned, the presence of limited opportunities on the Dutch public equity market does not necessarily constitute a problem in itself. As long as there are enough other options for investing in listed companies with comparable standards of corporate governance and transparency through other regulated markets, such as in the United Kingdom - and these options exist at present - Dutch institutional investors are not significantly constrained in their options for meeting their (fiduciary) responsibilities. The position is obviously different for institutional investors who have decided to base their investment policy on a Dutch home bias.

69. The Dutch IPO market, which is functioning less well for small and medium-sized companies, may indirectly constitute a problem for institutional investors, however. This happens when the decline is part of a wider international trend, which currently seems to be the case, as is described in section 5. The investment opportunities for institutional investors are adversely affected when the public equity markets are less deep and wide. The public equity markets then offer institutional investors fewer opportunities of gaining efficient access to the best-performing and/or fastest-growing companies.

Dutch companies

70. The unsatisfactory performance of the Dutch IPO market is unfavourable for Dutch small and medium-sized companies in principle. Well-functioning public equity markets can be an important source of long-term finance and the realization of the potential that companies have for growth. This is particularly true of the medium-sized Dutch companies for which it is less easy to raise capital on foreign public equity markets.

71. An IPO market which is not functioning satisfactorily restricts opportunities for raising additional equity capital, while shares/equity capital can give an enterprise a certain resilience during economic downturns. When the stock market is unable to satisfy companies' intrinsic needs for more equity capital in order to grow, an equity gap develops.[54] This equity gap could lead to smaller companies – and certainly those that are dependent on the Dutch capital market - opting (1) to invest less and grow less or (2) to use more debt finance and less equity capital to finance growth.
Overbanking increases the risk of financial problems and even insolvency during economic downturns.[55] Expectations are that an equity gap of this kind could develop in the coming ten years [56] and it is important to prevent this from happening.

[54] European Commission 2013 I.
[55] ASC-ESRB 2014.

8. Conclusions and recommendations

72. Eumedion concludes that many institutional investors, (potential) listed companies, banks, Euronext Amsterdam and retail investors have clear and rational reasons for not giving preferential treatment to Dutch or European small cap and mid cap listed companies on the public equity markets. The resultant of this is, however, that the public equity market is not performing in the best possible way in its function as a source of finance for Dutch small and medium-sized companies and – as a reflection of this – is not offering more opportunities to investors to achieve long-term returns. The importance of the public equity market for the Dutch economy has declined as a consequence.

73. It is assumed that when Dutch institutional investors invest in the Dutch economy this has a favourable effect on job creation and subsequently also on the capital accumulation and coverage ratio of pension funds and other institutional investors. This assumption appears to apply to initiatives such as the Dutch Investerings Instelling (NII: Dutch Investment Institution) and the related Nationale Hypotheek Instelling (NHI: National Mortgage Institution), the MKB-financieringsfonds (Finance Fund for Small and Medium-sized Companies) and the NL Ondernemingsfonds (Dutch Entrepreneurs Fund). What is less certain is whether the assumption also holds good for the investments made by Dutch institutional investors in listed companies through the Dutch regulated market. This deserves further research. It appears thus far that when stock exchange operators provide specific incentives to improve the climate for small cap or mid cap listed companies, this may have a positive effect on the domestic economy, as is shown by the findings of the OECD:

Stock markets that provide significant economic incentives to support small companies and associated infrastructure in the aftermarket will create higher rates of capital formation that, in turn, will generate jobs, economic growth and tax receipts.[57]

74. Consideration should be given to enhancing the attractiveness of the public equity market as an alternative source of growth finance for Dutch companies, in addition to private equity and debt finance. This could help to reduce the gap that has developed between private and public equity financing. Dutch companies with the potential to become small cap or mid cap listed companies need to raise capital; a regulated equity market may be a suitable platform for meeting their needs and may also offer an intrinsically good environment for providing that growth capital.

We would like to make the following recommendations to this end.

I. Information and dialogue

75. The provision of information and the communications connected with IPOs should be designed in such a way as not to be unnecessarily burdensome for listed companies, while at the same time offering

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[56] McKinsey 2011.
[57] OECD 2013 I

potential investors sufficient and carefully presented opportunities to become familiar with the new listed company. There should be as little information asymmetry as possible between listed companies and investors.

- The executive board of the future listed company should develop a dialogue with a number of investors with long-term investment horizons at an early stage in the process, at least a year before the IPO. This dialogue should be continued and extended where possible following listing.
- The time that institutional investors have to prepare themselves for an IPO should by extended by timely publication of what is known as the registration document (part of the prospectus) in advance of the formal launch of the IPO, so that they can give good feedback to the company during road shows before the price range is determined. The securities note can then be published later.[58]
- Ensure that research by independent analysts and preferably from credit rating agencies as well is available at road shows, in addition to documentation and research connected to the underwriting syndicate.
- Carry out critical and comprehensive research into the advantages (in terms of lowering the threshold for companies etc.) and disadvantages (in terms of loss of investor protection etc.) of the proposal to offer smaller new listed companies the opportunity of using the limited (SME) variant of International Financial Reporting Standards (IFRS) during the initial years of their listing.[59]

II. Lower the costs of an IPO

76. Although the costs of an IPO on the Amsterdam stock market may not be excessive in comparison with other markets, Eumedion believes that a small cap that needs to use an estimated 8.7% of the gross capital raised to meet the costs of an IPO is being charged excessively.[60] The costs mainly consist of the listing fee for Euronext Amsterdam, underwriting fees for banks, and fees for advisors (accountants, bankers and lawyers). In an absolute sense the costs depend on a number of factors, including the scale of the market capitalization, the size of the company, the nature of the company, the complexity of the transaction and the width of the distribution. The fees paid to underwriters and advisers often consist of a fixed component and a variable component. In order to make the costs more proportional and transparent, and to make the IPO market more attractive as a consequence, the following measures are recommended:

- Euronext Amsterdam, the underwriters and the advisers should adjust their revenue models for IPOs from smaller listed companies, in order to lower the costs of IPOs and to make the Netherlands public equity market more accessible to Dutch companies.
- The allocation of the variable component of the fee should be explicitly based on criteria that reflect the success of the IPO after the listing, such as: the stability of the share price of the new company, the degree to which shares have been taken up by stable long-term shareholders, and the quality of the prospectus and the other documentation in the eyes of investors.

[58] Section 5:15 Act on Financial Supervision (NL).
[59] Suggestion from Steven Maijoor, ESMA chair, Eumedion Symposium, 8 November 2013
[60] KPMG 2013, ESMA SMSG 2012.

- The prospectus should provide differentiated transparency on the fees agreed on with the underwriters, the advisers and Euronext Amsterdam, including the appropriate criteria and the maximum amounts for the variable components of the fees.

If IPO costs are reduced, the "backdoor" of reverse listing (the listing of Inverko N.V. for example, via the existing listing of Vivenda Media Groep), which is also dubious from the point of view of investor protection, will also become less attractive.

III. More favourable tax treatment

77. The following tax incentives could be considered in order to make the public equity market for Dutch companies more attractive:

- Attempt to achieve a better balance between the tax treatment of debt finance (interest payments are deductible) in relation to equity capital, which offers no similar tax relief. Budget neutrality should be the basic principle in this respect.[61]
- Lower the threshold for the participation exemption to 3% in due course, bringing it into line with the percentage at which investors must disclose their shareholdings.
- If the Financial Transaction Tax were to be introduced - which Eumedion is not supportive of[62] - consideration could be given to exemption for transactions in shares in listed companies with a market capitalization of ≤ € 1 billion.

IV. Removal of unnecessary regulatory impediments

78. Efforts should be made to bring about amendments to Solvency II, so that investment in the shares of listed companies becomes more attractive again for insurers. In the course of the current revision of the Netherlands Financial Assessment Framework and the new European pension directives, (concentrated) investment by pension funds in shares in listed companies should not be discouraged, but should actually be facilitated instead and made less complex.

V. Increased liquidity for small and mid caps

79. Share liquidity is important for listed companies and potential shareholders alike. The liquidity of shares in small caps and mid caps could be enhanced by the introduction of one or more attractive sector indices, either at European level or not. These could include sectors that are relatively strongly represented in the Dutch economy, such as agrifood, water, life sciences/healthcare and sustainability. Once sufficient mass has developed in these sectors, they will attract more domestic companies and investors as a matter of course.

VI. Encouragement of engaged share-ownership

80. Large amounts of the assets entrusted to many pension funds and institutional investors are managed passively by them for reasons of cost efficiency. When they demonstrate just as little engagement with

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[61] ASC-ESRB 2014, European Commission 2013 II.

[62] See the letter that Eumedion, the Federation of the Dutch Pension Funds, the Dutch Association of Insurers and DUFAS (the Dutch Fund and Asset Management Association) jointly sent to the Dutch Minister of Finance on 11 January 2012 on the subject of the proposed directive for a financial transaction tax.

the companies in which they invest, there is an inherent danger that too few active investors will remain who critically analyse and monitor individual listed companies, work that is necessary to maintain the efficiency of the stock market as such.

Engaged share ownership may offer a solution. Institutional investors with long-term investment horizons could more actively pursue engaged and well informed share ownership in Dutch companies, also with regard to smaller and medium-sized listed companies.[63] Increasing numbers of institutional investors are prepared to enter into a dialogue with listed companies in which they invest and they develop an engagement policy for this purpose. The European Commission has made engaged share ownership a prime focus of its policy, with its recent proposal to amend the Shareholder Rights directive.[64] Listed companies could encourage true engagement on the part of shareholders by providing investors with good information (see point 1) and by committing to direct dialogue with institutional investors. A robust and predictable distribution policy (on dividends in particular) is an important factor in this respect. A number of institutional investors are already specifically emphasizing engaged share ownership at small and medium-sized listed companies. In addition, some institutional investors have released funds for specific concentrated investment in small and medium-sized (European) listed companies.

VII. Active approach by Euronext Amsterdam and other relevant parties

81. Euronext Amsterdam would be wise to develop an effective strategy, possibly jointly with the ministries and regulatory authorities involved, for making an active approach to Dutch companies that have the potential to become small caps or mid caps but whose shares are not yet listed in Amsterdam,[65] The Canadian and Polish markets, which have relatively many IPOs for small cap and mid cap companies, may offer good points of reference. The strategy should also extend to companies which initially will imply relatively low market capitalization.

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[63] Barton & Wiseman 2014.

[64] Proposal of 9 April 2014 from the European Commission to amend the European Shareholder Rights Directive (COM (2014) 213 final).

[65] The Enternext set up in 2013 appears to be a good first step, but seems to be mainly successful in other markets at present.

Appendix I: Members of the working party

Rients Abma (Executive Director Eumedion), chair
Willem Beltman (Company Secretary AEGON)
Kris Douma (Director Responsible Investment and Governance MN)
Marc Hutten (Senior Portfolio Manager Equities Syntrus Achmea)
Herman Kleeven (Head of Focus Equities Portfolio Management APG Asset Management)
Felix Lanters (Head of Long-Term Equity Strategy PGGM)
Elbert Rodenburg (Executive Vice President Investment Services Robeco)
Holger Weeda (Head of Dutch Equity BNP Paribas Investment Partners)
Wouter Kuijpers (Senior Legal Counsel, Eumedion), secretary
Martijn Bos (Policy Adviser Reporting and Audit, Eumedion)

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