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Investor Engagement Solutions

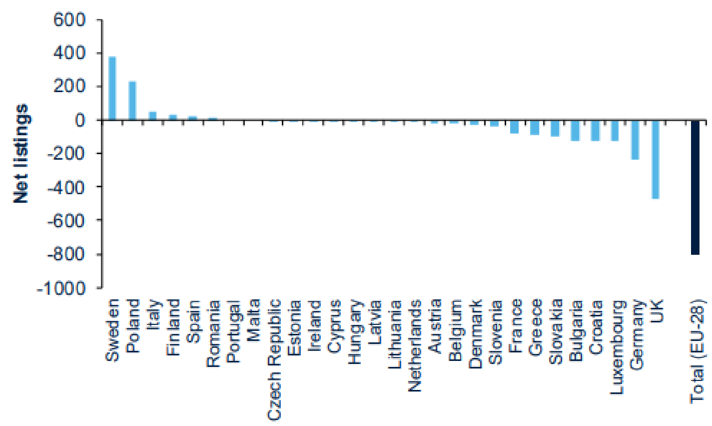
How to fix European SME capital markets

…and what is it with the Swedes?

Sweden has hit the headlines in a big way this year. Many say it has shown the rest of Europe how to react to a crisis and, although it has come in for some flak as second-wave cases surge, when one looks at the (touching wood) very contained connected fatalities, they may have a point.

Whether or not the country deserves high regard for Tegnell's cool-headedness has been the subject of many inflamed debates, but there is an area (no literary flair in this post – it's in the title) where undisputable facts show that Sweden leads Europe. Its listed SME scene is by far the most vibrant, as borne out by its bucking of the dismal trend in new listings. The chart below comes from a very serious, excellent report from Oxera, commissioned by the EU, and described as contributing "to the evidence base needed to further advance equity markets in Europe", which repeatedly cites Sweden as a blueprint for breathing new life into the listed arena.

Figure 2.9 New listings net of delistings in the EU-28, 2010–18



Note: Calculated as the number of listings in 2018 minus the number of listings in 2010. See note to Figure 2.8.

Source: Oxera analysis of stock exchange data; WFE.

At 130%, Sweden's market capitalisation to GDP ratio is the highest in Europe. Does that help anyone other than investment banks? The report says yes.

"An important policy question is what this means for the democratisation of wealth creation and retail participation in stock markets, and what is the impact on the real economy? As companies, especially ones in high-growth disruptive industries, choose to stay private for longer, investors limited to public markets miss out on an increasingly large part of the economy."

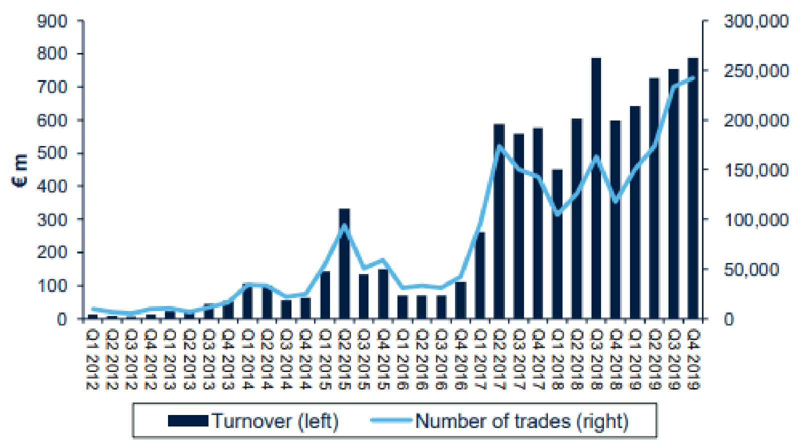
Of course, the man-on-the-street's pension fund may have some exposure to private markets but, by and large, VC and PE are the premise of institutions, sovereign wealth funds, UHNW and family offices. As set out by Merryn Somerset Webb in her FT article (posted here), this means that the majority of European savers end up missing out on the wealth-creating effect of avant-garde innovation and entrepreneurialism. In the interest of tackling real and perceived inequality, not to mention increasing levels of ESG oversight, Governments would be well-advised to put in the effort to reverse the current decline in listings.

Thriving stock markets may also have an impact on entrepreneurial culture. Spotify, Europe's most successful internet stock, came from Stockholm, and a recent article in the UK's Daily Telegraph talks of Sweden "threatening to eclipse the UK as technology capital of Europe". In 2019, British start-up funding was still four times Sweden's but, per capita, the Nordic nation comes out around 40% ahead. In truth, the article does not talk about the stock market, but it is worth mentioning that the UK, albeit also a net de-lister, is the runner-up to Sweden in market cap to GDP.

What the article does cite as a driver, among other things, are the tax reforms of the 80s and, in particular, the lack of any form of wealth tax. Also, a local serial entrepreneur told me that a major factor in the development of the country's equity culture had been tax incentives for investment included in those same reforms, which spawned a thriving asset management industry. So much so that foreign ownership of Swedish SME's tends to be a good deal lower than similar companies in Germany, where a nascent equity culture emerged in tatters from the Neuer Markt implosion in the early noughties.

The Oxera report also mentions Swedish Tax incentives, referring to a further round in the 90s. It reinforces the argument in favour by extolling the success of PIR tax incentives introduced in 2017 in Italy, which, is one of only 4-5 countries that flank Sweden above the line in the new listings chart above.

A4.4 Liquidity on AIM Italia, 2012–19



Oxera analysis of Borsa Italiana data.

Not surprising then, that one of the top 3 policy recommendations for the report's first recommended development path is "Use tax incentives". Also in the top three is giving investment managers dedicated SME money from the EIF to run, which we fully concur with, as the creation of an ecosystem of qualified, long-term investors is paramount. That said, creating a favourable tax regime would achieve the same end, and without direct use of supranational funds. In the words of Charlie Munger, "show me the incentive, I'll show you the outcome".

An important caveat is the liquidity conundrum of how to avoid creating a vast array of mutual funds holding illiquid assets which, in inevitable market downturns, run into problems when mass redemptions hit. ELTIFs, private-equity style fixed-term funds are mentioned in the report as a potential solution. Another, possibly simpler, idea would be listed investment trusts, which holders can buy and sell without affecting the underlying holdings.

The author doesn't know enough about EU law to understand whether tax incentives can be centrally mandated, and it would appear that, thus far, ELTIFs have run aground due to a lack of clarity regarding local tax treatment. That said, where there's a will there's a way, and one would hope that commissioning the Oxera report (hot on the heels of a similar, if less extensive one by the IPO Taskforce) is a manifestation of such a will.

Alternatively, we could just hand over the reins to the Swedes for a couple of years!

Max Casini

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