



GREEN PAPER 'Building a Capital Markets Union'  
European Commission 18.2.2015 (COM -2015- 63 final)

**ECODA REACTION**

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1. Some general introductory remarks

ecoDa welcomes the initiative of the European Commission to foster an integrated, well-regulated, transparent and liquid Capital Markets Union by 2019 for all 28 Member States. However, ecoDa would like to warn **against the belief that direct financing through the capital market is per se the most optimal format of corporate funding for all types of companies**. ecoDa would like to propose letting the choice of the best financing vehicle to the individual companies and the individual investors. In our opinion, it is not the one or the other, but finding the right balance between bank financing, other forms of financial intermediation and direct funding through the capital markets. We therefore have our doubts that the EU should strive for a financial framework comparable to the US.

However having a better functioning and well-diversified financial system, that takes full advantage of the economies of scale an integrated EU market offers, seems to us an important driver for stimulating growth by improving the availability and cost of growth financing. The Green Paper gives a good overview of the challenges ahead for reaching that goal. It is the opinion of ecoDa that **quite a number of the challenges described in the Green Paper cannot be solved with strict(er) regulation (alone)**. On the contrary, ecoDa wishes to suggest to the EU Commission making optimal use of this Green Paper consultation and the reflection that this will engender for further analysing the complex consequences and **spill-over effects of different regulatory measures**. It is our firm conviction that the issue of insufficient and inattractive funding possibilities for business firms might well be correlated -to some extent at least- to the regulatory remedies, installed to cure the financial crisis. So ecoDa would like to make a plea for not only performing a cost-benefit analysis of each new regulatory measure, but at the same time to have a closer look at the overall financial system and the complex interactions between regulation and the potential on impact and business consequences.

ecoDa would also like to refer to the **huge diversities of practice and culture**, not only across the EU but certainly also on a more international level; differences that might considerably influence (and determine?) the **role of the capital market**. Of course regulatory differences among Member States do hamper the creation of an integrated EU capital market, but all comparisons, between

Member States, but also with the US, should be treated with great care because harmonised regulations will not change those underlying cultural differences overnight. The same holds for the barriers for SMEs to access the capital market. Of course costs, economies of scale and risk profiles do play a role, but so do the willingness to keep the company under control (hence the great difference between Member States on the availability and use of control enhancing mechanisms), the reluctance to give full disclosure (e.g. on remuneration, on strategic issues), the resistance to get into the straight jacket of governance rules for listed companies (e.g. opposition against quota for board composition, against independence norms for board committees). These elements can explain to a certain extent the preference of SMEs for bank lending, or even private placement or the bond market over listing on a regulated stock exchange. As stated on page 13 of the Green Paper, SMEs may be reluctant towards listing on the stock exchange because they do not want to give up control or face greater external scrutiny. ecoDa would like suggesting to the EU authorities to attach more importance to those 'soft' elements when developing initiatives to foster an integrated EU capital market.

Aligned with the differences in (business) culture, corporate financing structures and the role of the capital market are the **attitude and willingness to take risks**. Therefore, ecoDa would like to suggest a further reflection on the degree of risk our EU-Society wants to take in compensation for more entrepreneurship and growth. Here again the difference with the US is straight forward, explaining to some extent the difference in financing preferences. Although ecoDa is convinced of the need for maintaining high EU standards to ensure market integrity, financial stability and investor protection, there is also a need for **further reflect on the trade-off** between risk and return. We should be aware that a risk-free society is impossible and that entrepreneurial ventures and the adjacent financing come at a certain degree of risk. In their endeavour to restore trust in the financial system, the authorities focused on risk reduction, increasing capital needs for financial institutions, setting stricter limits and capital requirements for investing in more risky assets and introducing more elaborate regulations on the distribution of financial products. Undoubtedly these measures diminished the availability and appetite for financial intermediation by banks and for investments of institutional investors in shares etc. Moreover public policies in general and the European financial regulation more specifically have focused on better risk management and increasing risk awareness of all parties involved. Many of the regulatory remedies decreased the risk profile of the financial institutions, but at the same time limited their potential role in the capital market and diminished the interest of institutional as well as retail investors for hugely investing in the capital market. Simultaneously, while the broad principles developed by soft law for major listed companies (e.g. having a sufficient proportion of independent board members, board committees for the board's preparatory work, transparency of remunerations) are generally transposable to SMEs, they are wary of the time consumption and cost associated with compliance and reporting. Fortunately the monetary policy of the EU and the prospect for further economic recovery again turned the attention to the relative attractiveness of investing in the capital market (with booming stock exchange rates as a consequence!).

## 2. ecoDa's reaction to some of the specific set of questions

*Q 28: What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?*

ecoDa would like to refer to its reactions to previous EU consultations, by first of all focusing the attention of the EU authorities to the fact that **most governance codes have been developed with**

**reference to the larger listed companies** and have therefore defined best practices and governance requirements in light of the specific needs and challenges these large(r) caps are confronted with. Although the comply-or-explain principle offers listed SMEs the flexibility to deviate from these (sometimes oversized or – even worse- less relevant) governance recipes, the institutional investors, asset managers and the proxy advisors dislike such governance deviations and consider them as inferior quality. So the solution might be threefold: (1) setting up specific stock exchanges for SMEs, (2) having different listing requirements per category of index, to be jointly developed by the stakeholders (SMEs, investors, analysts, rating agencies...) or (3) developing a societal culture that appreciates best fit solutions, combining deviations from the standard requirements with a high degree of accountability, grounded in pertinent explanations as well as credible monitoring systems. Based on our monitoring research, it is clear that many listed SMEs by far prefer the 3rd solution because they do not want to be perceived as a second rank class of listed companies, nor as being listed on a less attractive stock exchange. **Fostering such societal backing of the comply-or-explain principle** will be a long route, but an essential one to make capital markets more attractive for SME funding while at the same time offering an interesting way out for private equity and venture capital funding. The recent EU recommendation on comply-or-explain is an important step in this direction. ecoDa is investing time and effort in supporting this route further with its European-wide project, investigating the governance monitoring practices, the board decision-making process to define the best fit governance framework and practices and judging the quality of explanations.

It would also be worthwhile to further promote across Europe the development of alternative and less demanding stock exchanges for SMEs, e.g. in the form of “unregulated” MTFs and the like (which, incidentally, are not unregulated but just less regulated than the fully regulated stock markets according to the EU definition). Even with the most permissive attitude conceivable towards deviations from code provisions there will always be a large category of SMEs to which the requirements of fully regulated markets will be (perceived as) overly demanding. For SMEs that are not yet prepared to face those higher requirements we therefore consider it rational to offer some less burdensome alternatives as a way to incentivize them to go public rather than, as is often the alternative, selling out to private equity or to established industrial buyers. The Swedish experience may serve as an illustration of this. There the three leading MTFs together comprise more than 300 companies, which is slightly more than the two regulated markets combined. These MTFs fulfil an extremely important function for young entrepreneurial ventures as a source of capital for further expansion and a road towards a future as independent, listed companies on fully regulated stock markets.

A second point of attention, that ecoDa already highlighted in its previous reaction, is the fact that the attractiveness of capital markets in the EU is not only a question of harmonisation of regulations, but reflection should also be made **whether the business model underlying the stock exchange is valid for all types of listed companies**. It is straightforward that the commercial format of stock exchanges and their reliance on trading income to make their business model sufficiently performing are factors that are better met with listed companies having a large free float and many professional investors that are more of the type of share traders than shareholders. For SMEs this model certainly offers much more challenges (for the companies, the financial analysts as well as the stock exchanges themselves). **A more thorough reflection on the specifics of (potentially) listed SMEs is therefore necessary in order to make the capital market a more viable route for all parties involved.**

Thirdly, we would like to come back to the fact that the attractiveness of the capital market as a corporate funding vehicle for SMEs is hampered by their search for corporate control. Some capital markets in the EU offer to this end solutions in the direction of ‘control enhancing mechanisms’. ecoDa is convinced that the search for an integrated capital market at EU level may

**not ignore the question of a better level playing field as to control enhancing mechanisms..** From a societal point of view the most important justification for allowing dual-class shares is that the stock exchange entrance of new, entrepreneurial companies would otherwise be substantially delayed – if it would ever occur in view of the other alternatives usually at hand. Hence ecoDa supports the quest for a level playing field in Europe based on a “freedom of contract” principle. This suggestion would allow to improve the international competitiveness towards US stock markets as well. The fact that about halve of US companies have been incorporated in Delaware is only one signal in this respect. Or look at the governance constructions of high tech IPO’s in the US, like Google or Facebook, to name but the most prominent ones.

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**About ecoDa:**

The European Confederation of Directors' Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Its objective is to represent the views of company directors from EU member states to corporate governance policy-makers at EU level. ecoDa, the European Confederation of Directors’ Associations, is a not-for-profit association acting as the “European voice of board directors”.

Through its 16 national institutes of directors, ecoDa represents around sixty-five thousand board members from across the EU, ensuring that their views on Corporate Governance are clearly communicated to policymakers in the EU institutions. ecoDa’s member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

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