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Prospects for the Future Growth of the NewConnect Stock Market

Key words: *alternative stock market, sustainable growth, innovative undertaking, joint venture, private equity*

Abstract: The NewConnect market was created to aim small and medium companies in gaining the capital for their growth and development. It was created especially for companies with innovative type of production, services or trade. It attracts companies with low costs and less restrictive procedures than the main stock market. The NewConnect market builds possibilities for small companies to gain the stock capital. The companies listed in the NewConnect market concentrates over new, innovative technologies, especially in IT sector. Its operational first year gave it the first place in the amount of debuts and is one of the fastest growing markets in Europe. After two years of its existence, the Polish alternative stock market is beginning to start the second phase of its growth. The present paper shows a comparison of NewConnect with international alternative stock exchanges. The article determines the position of NewConnect among other European alternative investment markets. It briefly explains the prospects for its growth and attempts to answer the question why it will be very difficult for the market to develop into an international one.

INTRODUCTION

The NewConnect stock market was created in 2007 as an alternative stock exchange market in Poland. In its underlying assumptions it was a place for small and medium enterprises with short history and comparatively low asset and book values but with great potential of future growth due to its innovative and trail-blazing technology or idea for business. It was a natural next step in the development of the Polish Stock Exchange in Warsaw. The future growth and development of alternative stock markets, referred to as Multilateral Trading Facility (MTF), is determined by many random factors. Alternative Stock Exchange Markets and Multilateral Trading Facility Platforms may be used interchangeably.

The development of a capital market can and should be measured by the number of listed companies, value of public offer of securities and, of course, by capitalization of the market. It is important to remember that the last feature may not be applicable because of high volatility of the market, especially the companies listed on it.

ORIGIN OF ALTERNATIVE STOCK MARKETS

The need of creating new alternative stock markets for small and medium enterprises, which have short history record and very little business experience was not born in the 90s of the previous century but the in the early 70s. The NASDAQ (National Association of Securities Dealers Automated Quotations) Stock Market was the very first. The Alternative Stock Market was created in 1971 in United States of America and was fully computerized. A few years later, in the end of the 70s, European alternative stock markets started its existence. In France – *Compartment Spécial* (1977), in Italy *Mercato Ristretto* (1978). Great Britain created the MTF *The Unlisted Securities Market* in the early 80s of the previous century.

Table 1. History of European Alternative Stock Markets creation

Name of Alternative Stock Market	Date of creation
Compartment Spécial, French Exchange	1977
Mercato Ristretto/Expandi, Italian Exchange	1978
Unlisted Securities Market, British Exchange	1980
Bors 3, German Exchange	1982
Officiele Parallel Markt, Nederland Exchange	1982
Segundo Mercado, Barcelona Exchange	1982
Swedish OTC Market, Swedish Exchange	1982
Second Marché, French Exchange	1983
Stock Exchange II, Bors II, Norwegian Exchange	1984
Second Marché, Belgian Exchange	1984
Segundo Mercado, Bilbao Exchange	1986
Segundo Mercado, Madrid Exchange	1986
Gergelter Markt, German Exchange	1987
Third Market, British Exchange	1987
Dutch Participation Exchange, Nederland Exchange	1992
Second Marché II, French Exchange	1993
Alternative Investment Market (AIM) British Exchange	1995

Table 1 – continued

Name of Alternative Stock Market	Date of creation
EASDAQ	1996
Nouveau Marché, French Exchange	1996
Euro.NM Belgium, Belgian Exchange	1997
EURO.NM Amsterdam, Nederland Exchange	1997
Neuer Markt, German Exchange	1997
STAR, Italian Exchange	1998
SWX New Market, Swiss Exchange	1999
NM-List Finland Exchange	1999
Techmark, British Exchange	1999
Nouvo Marcato, Italian Exchange	1999
SMAX, German Exchange	1999
Austrian Growth Market, Austrian Exchange	1999
Nuevo Mercado, Spanish Exchange	2000
ITEQ, Ireland Exchange	2000
Nasdaq Europe, US Exchange	2001
Next Economy/NextPrime, Euronext	2003
Prime Standard, German Exchange	2005
Alternext, Euronext	2005
EuroMTF, Luxembourg Exchange	2005
Firsth North Alternative OMX, OMX Exchange	2005
Entry Standard, German Exchange	2005
Alternative Market (EN.A) Athens Exchange	2007
NewConnect, Polish Exchange	2007
Oslo Axxess, Norwegian Exchange	2008
AIM Italia, Italian Exchange	2008

Source: own elaboration based on (Kordela, 2009, pp. 370–371)

In spite of the fact that British alternative market was created almost ten years after the creation of NASDAQ, it was a great revolution for small and medium companies which were considering a stock market. In these years the debut on London Stock Exchange was highly regulated. It was strictly forbidden to list the companies with:

- short business history record (less than three years),
- less than minimum £500.000 capitalization,
- less than 25% securities in public trade.

The *Unlisted Securities Market* regulations were reduced to:

- no capitalization restrictions,
- two years business history record,
- 10 % of securities in public trade (Wisła, 2008, pp. 174–176)

The biggest Alternative Stock Exchange in Europe was created in 1995. The *Alternative Investment Market (AIM)* was organized by the London Stock Exchange (LSE). It is a strong modification of the earlier British UMS. Nowadays, AIM is a very popular and widely open stock market with very liberal regulations. It is an exchange regulated market with characteristic features:

- Company pretending to obtain the status of the company listed on AIM has to cooperate with a financial advisor authorized by LSE;
- Cooperation with the financial advisor is continuous – the authorized advisor risks his own reputation and is responsible for the company's creditability and reliability;
- A pretending company generates a document concerning basic information about the company and emission of securities – if compared to a prospectus it is a much simpler document but has to be published at least one month before the public offer of securities;
- Application document is not verified by the central supervising institution but only by the authorized financial advisor and market operator – LSE;
- Companies listed on AIM do not have to generate quarterly instalments and audited semi-annual reports (EU Commission, 2000, pp. 35–39).

DETERMINANTS OF DEVELOPMENT

The development of Alternative Stock Exchanges in the early years of the XXI century shows investors' significant interest in small and medium companies with innovative business characteristics. The main reasons for the creation of new alternative stock markets was the liberalization of capital flows in a global sense and the *Markets in Financial Instruments Directive (MIFID)* of the European Commission (Przybylska-Kapuścińska, 2007, pp. 301–302).

Also, the creative accountancy scandals (for instance, the case of ENRON) affected significantly the launching process of new markets. Due to this fact, the Sarbaney-Oxley Act was introduced in United States of America in 2002. The amended law tightened the restrictions for public stock companies which contributed to the increase of investors' trust. However, this change in regulations generated higher costs to be borne by the main Stock Market companies. The companies started to search for alternative stock markets that would be less restrictive and with lower costs of public offers (Kordela, 2009, pp. 371–372).

The implementation of the New Basel Capital Accord – Basel II in 2007, had also a big influence on the development of alternative stock markets. In fact,

small and medium companies became much more expensive clients for banks. According to the act from Basel, a bank as to establish own funds for credit protection and they should be dependent on the risk level. It generates a simple correlation – the higher the risk on receivables, the higher own capital reserve should be. Small and medium enterprises started to search for the capital for innovative businesses on alternative stock exchanges (Bielawska, 2007, pp. 10).

COSTS AND LISTINGS PROCEDURES ON THE WARSAW STOCK EXCHANGE

The procedure for debut of listing on the Warsaw Stock Exchange is a complex process. The costs of this process may be divided into three groups:

1. Costs of registration, administrative and court charges called *admissibility charges*;
2. Costs of *remuneration of financial advisors* which may be negotiable;
3. Costs of marketing and promotion of the public offer called *Promotion costs* (Adamska, 2008, pp. 143).

Table 2. Costs of public offer and listing on the WSE

Type of charge	Cyclicity	Main Stock Market	Parallel Market	New Connect
Introduction of securities listing in the stock market	Singular	0.03% of offer value (8,000 – 96,000 PLN)	2,000 PLN	3,000 PLN
Admission of securities for public offer	Singular	3,000 PLN	3,000 PLN	None
Securities listings	Annual	0.02% of market value (9,000 – 70,000 PLN)	0.02% of market value (3,000 – 8,000 PLN)	3,000 PLN
Stock option right listings	Singular	3,000 PLN	2000 PLN	Doesn't apply

Source: own elaboration based on Adamska, 2008 pp. 144, 492.

Companies listed on the Stock Exchange suffer certain consequences, including paying stock market charges. They vary according to the market and country in which the company is listed. The Warsaw Stock Exchange has basically two Stock Markets – The Main and the Alternative – The NewConnect market. The charges are completely different (Table 2.). The types of charges depend on the type of company that is listed on the WSE. Generally, the Main market is designed for bigger companies with certain business history for whom the stock

market debut is a natural next step of growth. The costs are much bigger than on the NewConnect Stock Market which was created in 2007 for small and medium companies which want to finance their innovative solutions for businesses. Financing innovative solutions by banks is practically impossible because of the high risk level incorporated in the start-up phase. In practice, the overall listing costs have a 5–7% share of the offer value. The lowest possible cost for the main market is estimated to be about 150,000 PLN. On the NewConnect market the debut costs are lower since. For instance, for InteliWISE S.A. it was only 0.63% of the offer value and the company paid only 31,000 PLN including the remuneration of the authorized advisor and the offer promotion. These figures show the advantage of the NewConnect, if lower costs are concerned.

EVENNESS GROWTH OF SUPPLY AND DEMAND

Stock Market is part of capital market and of course a market in a broad economic sense. The main regulation which governs every market is the rule of supply and demand. On a Stock Exchange Market the supply is the public offer of securities (original offer) or securities sale by investors (aftermarket) (Nawrot, 2008, p. 24). For companies offering securities, the public offer is always a possibility of gaining capital. The case of sale of securities by institutional or individual investors is not so simple. The investing strategies, past income realization, market outlook, macroeconomic factors, political instability, and many other, are the factors affecting a decision making process in sale. However, it is important to underline the reason of gaining profit through the sale of securities.

The other side is always the demand. It is represented by all investors who are willing to give their capital to the company to participate in its profits in the future. They can be divided into individual investors (all people taking part in stock market operations) and institutional investors (investment funds, retirement funds, hedge funds, banks etc.).

The most important for the future growth of a stock market is the number of new public offers, especially in the group of countries called *emerging markets*. The activeness of investors is, and should be, read as a market volatility factor.

Polish accession to the European Union had also a great impact on the development of the Polish Stock Market. It is commonly said that it already has had, and will have its consequences in the future. European and global investors have changed their evaluation of making investment in Poland. The risk level has been significantly reduced in Poland since it joined the EU. The growth of GDP achieved by Polish companies, in the fact, generated an increase on the WSE (Wiatrak, 2008, pp. 21–22.).

In Europe there is noticed a phenomenon of the disappearance of regional stock exchanges in favour of capital market integration. The American stock

market has been integrated with the European stock market in the recent years. In Europe the EURONEXT Stock Exchange concentrates stock exchanges from several countries, including France, Belgium, Netherlands, Portugal and United Kingdom (Ciejpa-Znamirowski, 2007, pp. 7–12.). The last advantage is the introduction of one European currency – euro which eliminated the problem of currency exchange. Stock Exchange Market Development is a factor of increase information effectiveness. It is important to mark-the-market and mark the correct securities price, which leads to the raise of market transparency and trust of investors to the stock exchange market.

THREATS FOR THE FUTURE GROWTH

The integration of global capital markets generates several threats for the future local growth. Mergers other combinations of international stock exchanges are dividing the capital market into two groups:

1. Large, international Stock Markets,
2. Small, local Stock Markets.

Nowadays, in each European country there is only one national Stock Exchange in operation. A large integration was realized, firstly, between different cities in each country (e.g., in Spain). After that integration with Derivatives Stock Exchange took place. This process is almost finished. The only exception is the British Stock Exchange. This largest European financial centre based in London follows its own principles. It concentrates the capital from almost every country in the world. However, even such a big and highly developed capital market as in the United Kingdom was integrated with the New York Stock Exchange creating a stock market with the longest working hours.

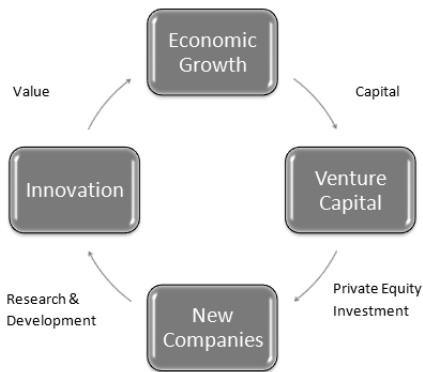
This kind of integration is concentrating more investors by gaining their trust to big stock market. Investors are attracted to the larger market which offers much more financial products and a wider range of possible financial investments. Hopefully, the Polish market is part of *emerging markets* and gives much higher profit possibilities. The problem of the future development is not the question if the NewConnect Stock Market will still exist in the future, but is the answer to the question whether it will be international or only a little local Alternative Stock Market (Ciejpa-Znamirowski, 2004, pp. 7–13).

Nowadays, this market has huge problems with its volatility. WSE is fighting with this issue. It is organizing a big promotion action in the biggest city in Poland to get more people informed about the NewConnect market. The present financial crisis had also a big impact on the lower volatility. Investors do not want to invest in risky businesses but are searching for low risk level investments such as gold or bonds.

DEVELOPMENT OF A STOCK EXCHANGE MARKET AND ECONOMIC GROWTH

An organized and well managed stock market can stimulate investment opportunities by recognizing and financing productive projects that lead to economic activity, mobilize domestic savings, allocate capital proficiency, help to diversify risks and facilitate exchange of goods and services (Mishkin, 2001, pp. 28.). Undoubtedly, stock markets are expected to accelerate an economic growth by increasing the liquidity of financial assets, making global and domestic risk diversification possible, promoting cautious investment decisions, and influencing corporate governance (Shahbaz, 2008, p. 183).

Figure 1. Economic growth dependencies



Source: own elaboration.

Moreover, stock markets are the best indicator of the forecast future economic activity and describe actual casual affect between future economic growth and stock prices (Filer, 1999, pp. 145–148.).

Innovation requires investments in R&D and marketing. These investments need substantial financing in order to be successful. The lack of capital is often cited as one of the most important constraints to innovation, especially in high tech and emerging industries (Giudici, Roosenboom, 2004, p. 147–151.). Stock markets play an important role in capital allocation into corporate sector that in turn stimulate real economy. Well organized and active stock markets can modify the pattern of demand for money, and will help in liquidity creation process that eventually can enhance economic growth (Caporale, 2004, pp. 44–46).

CONCLUSIONS

The development level of a national financial market is the key factor for a successful issue of shares. Investors are always aware of issuance and transaction costs and all other charges. Stock Market development gives an opportunity for information efficiency growth and proper valuation of securities. The rules governing the functioning of a Stock Exchange remain strict and unchangeable: the more transparent the market, the bigger the number of investors that trust it, and, finally, the higher the number of transactions made. This increases the market liquidity as well.

However, the main challenge for the present situation of the NewConnect market is to increase the liquidity and reduce the level of risky investments made there. The development of the Polish Alternative Stock Exchange Market should be mainly assessed by the number of listed companies and capitalization of the market. It is important to underline the volume of capital gained from the capital market. The NewConnect Stock Exchange Market is still in the phase of growth and capital offered through this method of financing is still not fully used.

The most important determinant of the development of capital market is the technology, including information technology implementation. Internet development has enabled the free fast information access. Moreover, it has integrated international stock exchanges. The law of the EU is the second important determinant. One 'financial passport' was invented by the European Commission for European financial institutions. Concentration of banks and brokerage houses is also important. Finally, the development of all international Alternative Stock Exchanges and higher level of competitiveness is also a factor impacting the future growth of the Polish NewConnect Stock Exchange Market.

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PERSPEKTYWY PRZYSZŁEGO WZROSTU RYNKU NEWCONNECT

Słowa kluczowe: alternatywny rynek akcji, wzrost zrównoważony, innowacyjne przedsięwzięcia, joint venture, private equity

Abstrakt: Rynek NewConnect został stworzony z myślą o pomocy małym i średnim przedsiębiorstwom w zdobyciu kapitału niezbędnego dla ich przyszłego rozwoju. Innowacyjny typ produkcji, usług bądź handlu jest cechą charakterystyczną tych przedsiębiorstw. Skupia on przedsiębiorstwa dzięki niskim kosztom notowań i debiutu oraz mniej restrykcyjnymi procedurami niż na rynku głównym GPW. Rynek NewConnect buduje możliwości dla przedsiębiorstw niemających możliwości sfinansowania swoich innowacyjnych przedsięwzięć przez, na przykład, kredyty bankowe. Przedsiębiorstwa zlokalizowane na tym rynku działają w wielu branżach. W swoim założeniu miały to być innowacyjne sektory gospodarki takie jak technologie informacyjne, biotechnologia, nowa, nieznaną jeszcze technologia. W 2008 roku był to najszybciej rozwijający się rynek w Europie, który wyprzedził nawet londyński AIM pod względem liczby debiutów. Po dwóch latach swojego istnienia polski rynek alternatywny rozpoczyna swoją drugą fazę wzrostu. Artykuł porównuje rynek NewConnect z alternatywnymi rynkami papierów wartościowych na świecie oraz na tle rynku głównego Warszawskiej Giełdy Papierów Wartościowych. Autor stara się ustalić międzynarodową pozycję dla rynku NewConnect na arenie europejskiej i międzynarodowej. Ponadto szczegółowo wyjaśnia perspektywy przyszłego wzrostu oraz pragnie opisać trudności przyszłego rozwoju oraz uznania go za rynek o charakterze międzynarodowym.