



Title	Economics of Junior Markets
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Citation	ECONOMIC JOURNAL OF HOKKAIDO UNIVERSITY, 19, 27-35
Issue Date	1990
Doc URL	http://hdl.handle.net/2115/30452
Type	bulletin (article)
File Information	19_P27-35.pdf



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Economics of Junior Markets

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Until the launch of Junior Markets (a special type of securities markets where even small businesses can list their shares) it was difficult to find any relation between small business policies and securities markets. We can not deny that securities market in advanced countries had been very exclusive only for big or nation-wide businesses. However things changed in these ten years. The purpose of this small paper is to describe the background of this big change.

In order to get an outline of idea it seems to be convenient to draw next two diagrams:

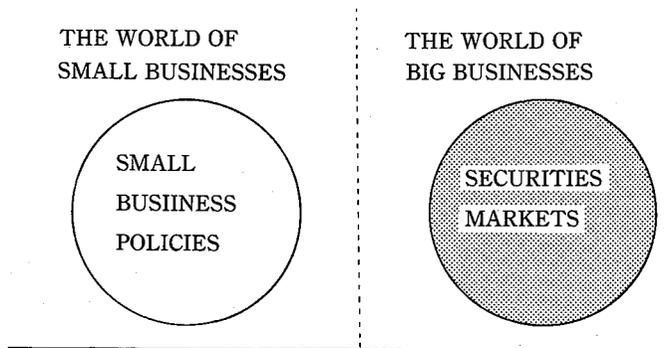


DIAGRAM 1

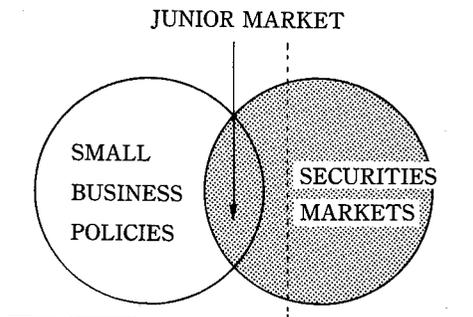


DIAGRAM 2

It is not so difficult for us to accept the basic idea (instantly indicated in two diagrams) that Junior Markets, which are developed in some countries since the end of 1970's, were formed in the common field of two circles (small business policies and securities markets). The next point we should explain is "Why did these two circles make a contact each other?" The question looks very reasonable because two circles traditionally and originally had been separated for a long time. Something happened and we have to research, "What's happened?" Basically there are three ways to explain this combination as follows:

- Circle A (Small Business Policies) moved toward Circle B
(Securities Markets)
- Circle B moved or swelled toward Circle A
- Both cases happened together.

First of all, let's concentrate our attention to Circle A. The definition of small businesses is a relative one against to big businesses. It is a reason why the threshold between them is very obscure in every country. "What are small businesses?" Only one answer accepted worldwide is "All companies except big ones."

However we also can accept that small businesses have been overwhelming superiority in terms of number, for instance, over 99% of all businesses belongs to the genre of small business under the official definition in Japan. Therefore if we want to touch a real aspect of capitalist society in any sense we have no other way than to make an approach to the world of small businesses. Small businesses are essential, in other words, every capitalist society consists of small businesses and this is a reason every country is forced to seek for some kinds of small business policies. Needless to say, the emphasis of small business policies is different country by country and the wide variety of policies can be found in every country.

We say very simply, "Small Business" in two words, but actually it includes all types of businesses. In order to be effective a policy should need a sort of focus or emphasis. In Japan small business policy moved its emphasis time to time, for example, immediately after World War II, the most urgent issue was how to survive minimum sized businesses like self-employed businesses. An essential thing in those days was to prevent a rapid increase of unemployment because it made a society unstable and jeopardized the control of the Allied Force. In the era of high-growth economy a clear focus was put in "subcontracting small businesses". The purpose of Japan's Government was a modernization of subcontracting small businesses because they were essential to sustain export-oriented big manufactures. As a sort of social issue, "small business" has been treated and traced. Consequently we can see a wide variety of policies for small businesses whether it was effective or not to the actual

world.

We can see a very clear contrast in the U.K. We can hardly recognize policies only for small businesses until the report of Bolton Committee.¹⁾ The same thing can be seen in West Germany, where traditionally there has been an assistant policy toward Handwerke. The basic philosophy was not in small business but in social welfare. Handwerk was regarded as a key factor of social stabilizer. If we trace the similar way in France we can find the same result.

Let's return to Britain, thing changed here suddenly at the end of 1970's, when the enthusiasm for small businesses happened and simultaneously a wide variety of small business policies were executed mainly under the Conservative Government. Almost the same boom could be seen in France as well as in Germany, but a focus of policies was put in promising medium sized businesses, not in "small businesses" in general.

A mass unemployment in the first half of 1980's rised an urgent social problem in Britain. The rate of unemployment jumped to 13-14% in 1984. That is why small business policies were always carried out together with employment policies. It is very peculiar only to Britain and a clear evidence of this combination is that the Loan Guarantee Scheme is now treated not in DTI but in the Department of Employment. The purpose of small business policies is always two or three hold, for instance, it is requested to attain:

- * revitalization of economy by extract a vital spirit of small businesses.
- * to get a harmonization to a quick-changed industrial structure, from "hard to soft".
- * to prevent unemployment

In Britain it is clear that the biggest emphasis was put on the last point because of the bad condition of employment in those days. Additionally the Conservative Government preferred a sort of policy-mix instead of a strait paying of dole to unemployed people. From a long view small business policies were regarded as the cheapest way to reduce unemployment. A slogan of anti-unemployment got the first priority in Britain and nobody could be against it.

The different types of Junior Markets in Table 1 are mainly explained by the difference of small business policies in each countries. Small-sized business should be treated as a generator of employment in Britain, that is why the Third Market was launched only in Britain. Enthusiasm for small businesses can be seen in European Community as a whole. EC Committee declared in 1983 "European Year of Small Businesses" and strongly persuaded all member-countries to execute assistant policies for small businesses. The business Start-up Scheme, now reformed to the Business Expansion Scheme,²⁾ was a quick response of British Government.

EC also announced, "The Action Program of Small Businesses" and European

Investment Bank extended a special loan facility only for small businesses.³⁾ Briefly speaking this enthusiasm for small businesses pushed Circle A toward Circle B of our Diagrams. Similar course (not correctly the same) can be seen in USA as well as in Japan but in these countries small businesses policy has a long history. In USA a famous book by Shumach "Small is Beautiful." had a contribution to raise up a re-assertion of the role of small businesses to economic development. Simultaneously, the Small Business Administration presented a report titled by "The Vital Majority" which revealed that a big expectation to small businesses emerged. Also in Japan Government issued a booklet, "Re-discover of Small Business", its front page started with the next well-known sentence:

"Small Businesses are no longer a burden to Japan's Economy and they are essential partners who are expected to play the important role in Economy".⁴⁾

We can conclude that the basic philosophy of small business policies changed in the late of 1970's and a big expectation to small businesses emerged in 1980's in several leading countries.

Why did such a big expectation emerged? That is another question we should answer, but another paper will be needed if we try it. Instead, we can say here next: Expectation for small businesses is another expression of desperation or disappointment to big businesses which had led the economic development of our society but now they created a mass of unemployment and a relative small contribution to innovation. We had better to examine more about the concept of "expectation to small businesses".

According to Professor Sato of Keio University "expectation" consists of the next three categories.⁵⁾

- (1) In advanced countries; an expectation of re-vitalization or of a quick shift to the third industrial revolution
- (2) In developing countries; in order to make a progress of industrialization, it is more essential to promote their own small businesses than introducing big business from developed countries.
- (3) Both in (1) and (2); to generalize opportunities of employment

Actually, the expectation varies in countries respectively. In Japan, there had been a series of policies therefore this new type of small business policies are not so outstanding and rather vague among traditional long continued policies. On the contrary in the U.K. the expectation formed the first series of policies.

What moments pushed Circle B toward Circle A? This is the second issue we should consider next. It still remains the fact that securities markets are in principle only for big businesses, therefore only one idea to explain the transfer of Circle B is that securities markets, keeping its original position, swelled or extended toward Circle A. What factors caused this unusual matter? The first point is very clear, that is an official incentive by government. A typical example can be seen in West

Germany in 1986, when a special act to provide for small businesses an easy access to the securities market was passed and simultaneously the regulation, which prohibits the institutional investors from approaching small businesses, especially un-listed companies, was partly released. Tax recession can be classified to the first group. In Spain, investors (only to small businesses) can enjoy 10% cut of dividend tax, and as I mentioned before the Business Expansion Scheme in Britain can be regarded as an incentive for investment to small businesses. Tax concession to capital gain was carried out twice in the U.S., and in 1978 pension funds got a free hand to invest their fund to venture capitals. It contributes greatly to make a venture capital boom in the U.S. since 1979.

The second factor can be found in the change of security houses' activities. Venture capitals represent this change most strikingly. Almost all of them were founded as subsidiaries of securities houses in Japan after the first oil-shock.⁶⁾ Behaviour of venture capitals is, in principle, very clear: they invest their funds to some young and hopeful companies and several years after withdraw it with a capital gain.

A critical issue for them is "how to withdraw". Junior Markets provide them an ideal exit of their investment. It is quite natural that venture capital companies have been very keen to promote "Junior Markets". Besides capital gain securities houses can expect a very good free-business when a company lists their share to the market because it is very often accompanied a new issue. Companies which are thinking of newly listing always complain high-rate fee they must pay to some professionals (security houses, accountants, lawyers etc.) and actually this matter makes small but hopeful company very reluctant to go listing.

We can see the third factor in the Stock Exchange itself. The shutdown of local markets is a worldwide phenomenon, for instance, in Britain all local markets were closed in 1973. In the West Germany and Japan local markets still survive but they are not very active compared with each centre markets.

These matter resulted that stock brokers (houses) mainly located in a local area lost their jobs and it also means local industries faced a great deal of inconvenience, and finally "listing" became a unrealistic dream. To console all these complains the stock exchange should create something replacing local markets. An idea of opening a new market specialized for small businesses seems to be very attractive.

In some countries in Europe we can see another reason. Sometimes stock market itself does not like to see a free trading of unlisted securities only with self-restriction of brokers, and the stock market hopes to expand its control to these trading. In Britain the Stock Exchange tried to take a part of OTC trading into the inside of building and hoped to prevent any scandal, but that is one way thinking of the Exchange.

The last factor to lead the road to "Junior Markets" is a speculative movement of

money. Money excess syndrome can be seen in any advanced countries and it is showed with a high level of stock prices.

Generally speaking, money-flow is dividend into two streams, bank route and stock market route, in another words, indirect and direct course. First of all, we should consider bank route.

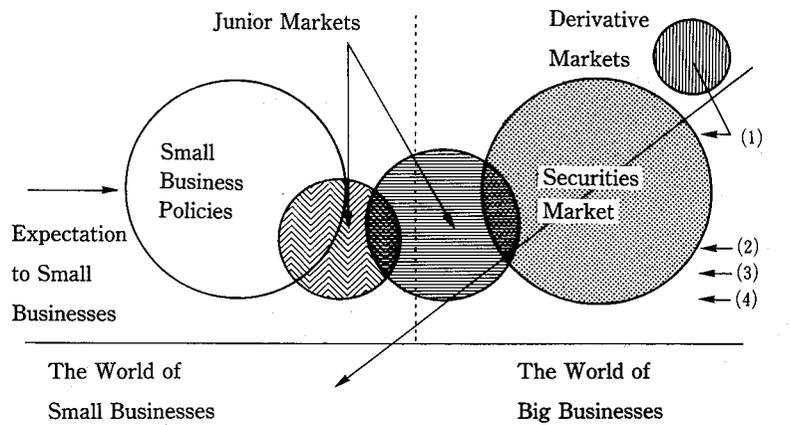
Big businesses getting a high-rate profit like motor car, eletronics, and high-tech industries, they no longer need to depend on bank borrowing because they have huge retained profit and not so many opportunities to invest. On the contrary, so called, chimney industries like steel, chemical and other heavy industries are obliged to stay at a very low stage of prosperity. Under the unprofitable condition an urgent matter of these industries is to cut the cost as possible as they can. Interest they should pay to banks is sometimes a major turget of "slim strategy". Companies always try to reconsider the need of external fund, finally resulted in the cut of bank borrowing and they pursue this strategy even to sell non-profitable factories and properties. Banks are now losing their old customers to large extent and new outlets of bank money should be founded or newly developed. So far, we can think of next three solution as it is possible, personal loan, international banking business and small business loans.

It is remarkable that big banks have developed a new type of loan specialized for small businesses. As a result, small businesses loan of 13 city banks reached over 50% of their total lending, that is true also in Japan. Can we see the same tendency in the course of direct finance? In this field we can find a rapid growth of international finance rather than small businesses. At the present it is not clear where excess money in the direct stream will go. But so far the size of excess money is too big to "Junior Markets" and too speculative to promote them. Speculation must get a profit in a short time but the purpose or slogan to promote small businesses needs a long waiting. If the characteristics of excess money will become more speculative, we can not expect it will contribute to promote the future of Junior Markets: It is very likely such a speculative money will flow to so-called "Shadow Markets" like future markets or several kinds of option markets, therefore we can say the development of "Junior Markets" is in the inverse relation to the flourish of these "Shadow Markets".

As a conclusion of this small paper we had better to draw the next diagram which, I hope, shows the present condition of "Junior Markets" better than my explanation.

Size of Junior Markets

	Market Capitalization of Official Markets (A)	Market Capitalization of Junior Markets (B)	B/A (%)
UK	363.1£ billion	7.87 (USM) 0.3 (The Third Market)	2.1 0.1
The Netherland	154.8Df1 billion	1.2Df1 billion	0.8
France (Paris)	1,277FF billion	132FF billion	10.3
West Germany (Frankfurt)	427.7DM billion	9.7DM billion	2.3
Japan (Tokyo)	330¥ trillion	4¥ trillion	1.2
South Korea (turn over)	20Won trillion	4.2Won billion	0.02



- (1) Speculation (Excess Money)
- (2) Behaviour of the Stock Exchange
- (3) Venture Capital
- (4) Incentive by Tax Concession

Junior Markets in the World (The End of 1988)

Name	The Number of Companies or Securities	Money Raised at Issue	Turnover	Market Capitalization	New Companies or Securities	Price Index
NASDAQ	4,451 5,144 (4,706)(5,537)	\$m.2,130 (\$m.6,110)	\$m.347,000 (\$m.499,800)	\$m.338,700 (\$m.325,500)	159 (402)	↑
Unlisted Securities Market (UK)	411 (370) Total Admitted 707	£m.1,021 (£m. 926.8) £m.3,467	£m.3,154 (£m.6,076) cumulative £m.36.0	£m.7,865 (£m.6,282) £m.126.9 () £m.300 (£m.210) 31,156 (Bargains) (37,455)	103 (75)	↓
Third Market (UK)	58 (34)	£m.13.0 (£m.23.0) cumulative £m.36.0	£m.126.9 () 31,156 (Bargains) (37,455)	£m.300 (£m.210)	24 (34)	⇒
Second Marché (France)	183 (176)	MF. 841 (MF.3,270)	MF.145 (MF.223)	MF.133,000 (MF. 99,877)	? (54)	↓
Parallel Market (Netherlands)	73 (65)	(MDf1 841)	MDf1 1,843 (MDf1 1,992)	MDf1 1,200 ()	10 (8)	↓
Gelegelter Markt (W. Germany)	129 (68+33)	49issues (16) (MDM 447)	MDM 31,000	MDM 9,700 (MDM 7,227)	11 (10)	
OTC (Japan) Feb., 1989	198 (200)	78issues (39issues) 200.1bil.yen (98.4bil.yen)	290mil.Shares 683bil.yen (181mil.Shares) (290bil.yen)	4 trillion yen (2.3trillion yen)	53 (19)	↓
OTC (S. Korea)	13 (7)		3.7mil.Shares (Decem. only)			↓ ↓
Segundo Mercado (Spain)	27		MW 4,258 480Thousand Shares (MW 1,260) (120thousand Shares)		12 (21)	30 companies at the end of Mar. 10bil won estimated in 1989.
Segundo Mercado (Spain)	4 (1)		MP 370 (MP 858)	MP 4,810	4 (1)	Mercapital (the first company) was quoted in Nov. 1986.

Sources)
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Notes

- 1) *Report of the Committee of Inquiry on Small Firms*, HMSO, 1971.
- 2) Colin Mason, John Harrison and Richard Harrison, *Closing the Equity Gap?*, An Assessment of the Business Expansion Scheme, Small Business Research Trust, 1988.
- 3) European Investment Bank in 1987.
- 4) Small Business Bureau of MITI, 1980.
- 5) This paper is included in "Small Business in Japan" edited by Tsuchiya and Miwa, Tokyo University Press, 1989. (only in Japanese).
- 6) Y. Hamada, "Venture Business" Boom in Japan, Hokudai Economic Papers, Vol. XIII, 1983-4.