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Worldwide Development of Junior Markets

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1) The World Development

"Junior Markets" means the securities markets small firms are allowed to be listed and offer their shares to the public. *Table 1* shows a brief history of this sort of securities markets as far as I recognized at the end of August of 1988. Considering the development of the junior markets in *Table 1*, three turning points can be pointed out; the first one is the launch of NASDAQ in the U.S.A. in 1971, which can be regarded as a historical starting point of this movement. This new market, possible for small firms to offer their shares to the public, has the three following features: at first, it is a securities market promising for the 21st century. Namely, they had made full use of computers and the latest high-tech communication techniques, such as a communication satellite. With these advanced facilities it realized a typical non-place market.

Secondly, NASDAQ is characteristic of its internationalism. It is not only because there are many foreign stocks of non-American enterprises, but because NASDAQ is linked to other securities markets in the rest of the world (cf. of London and Singapole)[1]. The last character that small firms can offer their shares to the public as already mentioned, as far as we can see the developing process of NASDAQ since its start, is not so remarkable as the above two.

It was not until the Unlisted Securities Market (USM) was launched in 1981 that this new type of markets grew to the sensational market for small firms. It is the jumping point of the junior market movement, which shall be explained in this paper. The decade from the launch of NASDAQ to USM is just the period of waiting for the emergence of a big expectation toward small firms. The U.K. has been suffering from a long lasting depression and the high rate of unemployment after World War II. Therefore the expectation toward small firms was enthusiastic and stronger than any other countries. USM was launched with the background of the small firms boom, which happened simultaneously in all of Europe. Other European countries started to follow this new fashion to overcome their own economic problems.

If we say that NASDAQ is a starting point and USM a jumping point respectively, the third market, launched in the U.K. in 1987, can be regarded the landmark showing the last stage of the movement. Because it provides a possibility that small firms can offer their shares to the public, the Third Market is, in the true sense of the word, the Market for small firms.

2) Three Types of Junior Markets

There is not enough room to explain all of the junior markets, so we had better

to select some representative ones and to show their outlines. In order to attain this purpose it is convenient to divide junior markets in *Table 1* into the next three groups. I owe this classification to Graham Bannock, British researcher of small firms.

The first group, where trading of unlisted securities had been approved to use the building under the unspoken agreement informally, and now comes to be authorized officially. Typical examples can be found in the U.K., France, and West Germany. In the U.K., the trade of unlisted securities has been done informally under the Article 163[2] of securities exchange market regulations, and it comes to be authorized and resulted in the establishment of USM. The ancestor of the junior market in France is called, "Hors Cote". In West Germany, it is called, interesting to find a strange name, "the regulated free trade market", Geregelter Freiverkehr in Germany[3].

It is easy to suppose if we consider the circumstances of approving the trade of the existing unlisted firms, that these junior markets are mainly for relatively large firms among small firms, not for small ones. A common strategy can be recognized here, to bring unlisted firms into securities market with the official approval, but the focus has been put on medium-sized firms.

The second type is the market for small firms rather than for medium-sized firms. It is actually a sort of revolution that small firms, which had never offered their shares to the public, come to be able to realize their long dream. It comes true fairly under the slogan, "Securities markets for small firms". The Third Market in London is a representative of this type and similar examples can be found in Belgium and Greece.

The last type is rather complex and it can be found in several European Countries, where the unlisted securities markets existed before are divided into next two; for the relatively medium-sized and for the small-sized firms, and both of those are recognized officially with a big accent on the former. The major policy of these markets is, as some researcher pointed, "sorting and selecting promising medium-sized firms among the business world". Parallel Market, in the Netherlands, is a representative of the third type, and similar markets can be found in Denmark and Italy, but the detail cannot be available.

3) The Present Condition of Junior Markets in Several Countries

My new book[4] already introduced the background, the pre-history and the general condition of junior markets, so it is convenient to avoid any trouble of repetition. The present condition after Black Monday will be shown very shortly with some tables and figures.

NASDAQ

The number of firms listed in NASDAQ in late 1987 is 4,706 and the number of securities, 5,537, both of them are number-one in the world. This difference of two numbers can be explained very easily to say that one firm can list several kinds of securities. The total value of trading in 1987 is reported $500 billion that is third-ranked just next to NYSE and TYSE. It is remarkable that the following two committees were appointed in order to reform NASDAQ. As known well, NASDAQ was shocked terribly by Black Monday, so the focus of discussion in

these committees was on "How to make its trade more smooth". Several months after they announced reports respectively. The report of the Regulatory Review Task Force re-examined the regulation and the watching system of NASDAQ. It was appointed in April of 1987, and submitted a report in March of 1988. According to it, the watching system of NASDAQ, although recognizing its high evaluation, must be more effective to check a doubtful trend of stock prices. Black Monday triggered off another committee, which investigated various measures to overcome the shortage of liquidity in NASDAQ. Actually almost stocks of NASDAQ were "unquotable" on Black Monday and the subsequent days. The Special Committee of the Regulatory Review Task Force on the Quality of Markets (the official name of the committee), was appointed in December of 1987 and submitted the final report in July of 1988. Due to a lack of the enough space to tell the details of both reports, I would like to emphasize here on the quick response toward the shock of Black Monday. It contrasts strikingly with the Japanese Over the Counter Market, which is on the brink of a crisis, being drawn into the politicians' bribery problem. *Figure 1* compares share price indexes of NASDAQ and NYSE after Black Monday. The valley at the crash was more deeper but it quickly recovered, and in the first half of 1988, the performance was a little bit better than that of NYSE. However things changed in July 1988; NASDAQ line moved below NYSE and the gap is gradually getting bigger. *Figure 2* shows the dollar volume of equity trading from 1983 to 1987. In 1987, it amounted to about $500 billion and also showed a constant increase since 1984. The volume of shares traded in NASDAQ are shown in *Figure 3*. The increasing tendency is the same as *Figure 2*. The total dealing of 1987 is 37.9 billion stocks and, to suppose the session has 250 days in a year, average dealing per day is about 0.15 billion. Considering relative high price of NASDAQ shares, that is remarkable.

Unlisted Securities Market in Britain (U.S.M.)

The total funds raised of the USM in 1987 was £ 184 million. It was rather small as compared with £ 300 million of the previous year (the year of 1986 was the boom of the USM and therefore the figure was an exception.) The figure of 1987 was almost the same amount as that of 1985. The recent report of Peat Marwich McLintock's informed that funds raised in 1988 amount to £ 303 million. The number of firms admitted to the USM is 58 for half a year in late June of 1988. The number of firms admitted to the USM in 1988 was 87, a little bit below the record attained in 1986 (91 firms) but showed a growth compared to 75 firms in 1987. In terms of two merkmals above mentioned a steady growth of the USM seems to be very clear. However the level of stock prices and the dealings of the USM were, as will be shown later, very dull in 1988. What is the reason for this gap? It is not because a lot of enthusiasm for opening their shares to the public was still hot, but because the firms, which have been prepared for opening for more than a year, could not abandon even in the bad circumstance after Black Monday, and also could not help but run on the existing railway leading to the destination of USM.

By 31st December 1988, 676 companies had obtained their initial quotation on the USM. Of these 128 have gone on to a full Stock Exchange listing, 111 have

been acquired, 8 currently have dealings suspended and 18 have had dealings cancelled; leaving 411 companies trading on the USM at 31st December 1988. Therefore it can be said that USM is still the leader of Junior Market movement in Europe.

The trend of average share price of USM is shown in a dotted line in *Figure 4*. The valley at the collapse is deeper than in the official market and took a lot of time to recover. *Figure 5* shows the monthly turnover of the USM. It can be separated into two parts very clearly with the threshold of Black Monday. The low liquidity is the most urgent problem of junior markets in Britain. To overcome low liquidity, it is necessary to raise the ratio of floating stocks at the offering, but some people worry that it may infringe the independence of small firms. According to the *Figure 5*, the USM has not recovered from the damage of Black Monday yet, and the same comment is common to the Third Market. A bold solid line in *Figure 4* shows the trend of stock price of the Third Market. It shows the worst damage among three lines at the crash mainly because of the low liquidity, but the sign of recovery is recognized in the Third Market, while it is not in USM. *Figure 6* shows the monthly turnover of the Third Market. It has recovered rapidly from May in 1988, but the total number of companies admitted to the Third Market since its start is still only 53 at the end of March of 1989, so it is still a long way to reach 200 firms (the target since its launch).

The Second Market in France

As to the Second Market in France, the data has not yet arrived completely and so the latest detail figures are not available. The number of firms admitted to le Second Marche of Bouse de Paris in the end of 1987 is 176. Compared with 84 firms in 1985 and 122 firms in 1986, it is quite clear that this new type of market in France has been growing steadily. But the stock price remains low and its index was lower than that of the official market (See *Figure 7*). Reflecting the low price in 1987, the market capitalization of the same year was 15 per cent less than in the previous year (1986).

The Second Market in France consists of relatively medium-sized firms, therefore it does not have any original trend of stock prices and always reflected the movement of the official market. Therefore two lines in *Figure 7* moved parallel but the gap between two is getting wider. Needless to say, it means "le Second Marche" is not so attractive to investors as the official market.

Figure 8 shows the monthly turnover of the second market, and as the people are worrying, it shows a falling tendency largely from February of 1987 and it recovered gradually from the bottom of April 1988. The total volume of transactions in 1987 reached 55,321 (thousand France Franc) but the result in 1988 was just between 1987 and 1986. Although the number of listed firms grew steadily, the total volume of trading fell as a whole. It was caused apparently by the low liquidity of this market as well as the low level of stock prices.

The Parallel Market in the Netherlands

The number of listed firms in the late 1987 is 65, and 8 firms out of them are in the classification of high-technology industry. The total volume of trading in 1987 was Dfl 1.2 billion, which was much smaller than Dfl 5.2 billion in 1986. But

according to the stock exchange of Amsterdam, things were exceptional in 1986 because of the issue of a takeover. In 1988, the parallel market seems to be going smoothly. *Figure 9* shows the weekly turnover, and in March 1987 the parallel market recovered from the shock of Black Monday. The trend of stock prices is shown in *Figure 10.* Generally speaking, small-scale markets in Europe are going smoothly. At the time of June, 1988, only the Netherlands, Belgium, and Japan broke the level of stock prices peaked before Black Monday. The Parallel Market is influenced by the bull-condition of the official market and it shows a "parallel" trend, nevertheless its standard level is rather low.

SESDAQ in Singapore

The monthly turnover was rapidly increasing until June 1988 as seen in *Figure 11.* However, it is not so remarkable because the original scale of this market is extremely small. The first purpose that the Singapore government intended when they planned to start the new market only for small firms, seems to be attained but continuous decline of turnover since July 1988 caused a difficult problem for government. As far as I confirmed at the end of April 1988, nine firms are admitted to SESDAQ and almost all of them improved profit for the year 1987. Trading activity on SESDAQ in 1988 rose substantially in line with bull market after Black Monday. Turnover for the first half of 1988 showed 85 per cent up to previous year and it comprised close to 3 per cent of the total volume of the main board, as opposed to 1.2 per cent in 1987. Average daily turnover came to 796 thousand shares, which compete enough to Japan's OTC. Market capitalization of the 9 firms amounted 432.5 (S$ million) with the contrast of 235.1 (S$ million) at the end of December 1987. Three firms are still trading below their issue price, however, average prices of all SESDAQ stocks improved considerably. The UOB SESDAQ Index which ended at 40.77 in 1987 and raised 25.58 points, or 63 per cent, to finish at 66.35 at the end of June 1988. In comparison, the SES All-Share Index recovered 54.95 points (22 per cent), so SESDAQ is the only one whose performance has been better than the official market. But, as I noted already, we must not exaggerate its growth because of a very small initial size of this market.

Over the Counter Market in Japan

The average number of shares traded is very small, about one million to two million shares weekly. (*Figure 12*) At the same time Nippon Steel was traded at the pace of over 100 million shares a day. OTC is just like an ant as compared with a big elephant: TYSE. *Figure 13* shows the stock price of OTC, it recovered rapidly and reached 1,400, which far exceeded the peak of 1,270 (October 13, 1987 just before Black Monday). However it fell down again from July 1987 and reached a deep bottom in November, largely speaking OTC is rather risky and difficult for investors to make money. The biggest problem here is also the low liquidity. Almost all investors have the same image of OTC "unquotable market" and this image is getting more popular day after day. Small firms, who should be host here, complained that, nevertheless they had realized to make their company "open" after a long effort, shares were not quoted after the first three days of opening. The political scandal of Recruit Cosmos (a company of real-estate dealings) made the future of OTC gloomy against the expectation of small firms.

Some people are discussing more strict standards of OTC registration to prevent some scandals but we can not deny that junior markets movement is a historical stream nobody can stop, therefore, the recent trend so-called, "more strict" is just opposite to the world trend. In stead of strength of regulation, we must keep a close eyes on ethics of politicians. It must be convenient of OTC in Japan. The number of firms newly admitted to OTC has been increasing as shown below:

Year	1983	1984	1985	1986	1987	1988
Number of Firms	30	24	30	44	51	56

People expect over one hundred firms will be admitted to OTC in 1989 and the total number of firms in OTC will exceed three hundred at the end of this year.

There is clearly a great contradiction between "Boom of Openning" and "low liquidity of OTC" above mentioned. One idea to solve this problem is to introduce a well designed computer system like NASDAQ (some people call it "JASDAQ"). In order to make OTC more vivid, enough information and quick trading will be necessary. It must be noted that we already have facilities to attain them.

4) Junior Markets and Small Firms

Three types of junior markets and the present condition of some of those have been mentioned so far. The next task is to answer three questions which are very likely to be asked. Is it really possible for small firms to list in securities market? That is the first and the most simple question. And what scale of firms is it possible? What influences do these junior markets have on the future of small firms?

At first, it is true the listing standard and the requirement of regislation of junior markets in each country, as I explained already in my book, are not so strict as that of the official markets. It can be said that small firms, if they really want, can approach to securities markets much easily than before, because there is no special limit in the amount of capital, profit, and operation years. Only one requirement, to which small firms will be asked some efforts, is the floating-stocks-ratio (at least about 10 percent) at the time of opening.

Let's see NASDAQ first. *Table 2* shows listed firms of NASDAQ by market capitalization. The number of firms with less than $25 million of market capitalization is 2,412, that is more than a half of all the listed firms of NASDAQ. The amount of market capitalization per firm is $920,000 on the average, approximately 110 million yen. Even in NMS(NASDAQ National Market), there are not small firms but mostly middle-sized firms, that is why they are called, "the core of NASDAQ", the number of firms there with less than $25 million of market capitalization are as much as 860, and market capitalization per firm amounts to $1.34 million, approximately equal to 170 million yen.

What is the condition in the case of USM? Market capitalization of the total USM shares amounted to £5.9 billion in the late November, 1987. £5.9 billion divided by 356, the number of firms listed in those days, equals £16.5 million. Market capitalization of the official market per firm at the same period amounts to £27 million on the average. At the simple calculation, it taught us that the scale of

firms listed in USM is rather larger than two-thirds of that of the official market. Considering that the average stock prices in the USM is a little bit higher than in the Official Market, it can be said the size of the USM firms is about a half compared with Official ones. According to *Figure 14*, which shows firms of the USM by the sales turnover, the annual turnover of majority ranged from £1 million to £3 million, (200 million to 600 million yen)[5]. Besides the recent extremely strong yen, it amounts to less than 1 billion yen in rough estimation.

The total market capitalization of the Third Market per firm is about £7.17 million, which is calculated on 34 existing firms at the end of January, 1988. The number of firms with more than £10 million of market capitalization is only 7, and £5 million to £10 million equal 14, respectively. Market capitalization per firm of the smallest group amounts to £2.82 million; approximately 600 million in yen. It is confirmed that small firms can list and actually offer their shares to the public. Finally let's discuss the last question, which seems to be very difficult to answer.

"Small firms are given a chance to offer their shares to the public", it sounds wonderful, but actually only hundreds or thousands (at most) out of millions of firms can do so. We must ask, "what meaning does junior markets have to the future of small firms?". Considering the whole number of small firms, only relative big ones near to the top of a pyramid can approach and use this new market. From the viewpoint of "quantity" all of junior markets are very negative but in my view the meaning of quality must be emphasized here. In order to make clear my view I had better to clarify the following three points.

The first point is the announcement effect of junior markets. One of the biggest dreams of the capitalist society has been "founder's profits". Whenever the possibility of founder's profit can be expected the spirit of entrepreneurs will be stimulated. Simultaneously this possibility plays the role of mood-maker of the new business movement. It also contributes as a necessary bandwagon of the government policies for small firms. Junior markets itself can be the core of small firms boom in each country.

The second effect is to stimulate the venture capital movement. Needless to say, junior markets itself provide the exit of money invested by venture capitalists because they can withdraw their money through it. In any country, venture capital activities come to be lively corresponding the foundation of junior markets, and their investment balances increases, too[6].

The third effect, the most important in my view, is so-called, "the structural effect".

In these years, the access of big banks to small firms often becomes a topic in main advanced nations. But in most cases, big banks put emphasis on relative big firms ranked next to the top of industrial structure[7]. They are, what we call, core first-ranked firms. It is true the development of junior markets helps these firms to pave the road of a direct finance. Suppose that funds demanded from large firms will not show much increase afterwards, banks will have to set their target of loan or investment to a more lower level of "the pyramid". However venture capitalists always seek for their customers in this field. The opportunities of indirect finance are, therefore, likely to decrease. This is the reason that the target of banks' indirect finance has to be set on one more rank below. Big banks, which has never welcomed small firms as their customers, are now willing to lend money

for the sake of them. Consequently big banks go into the competition with the existing financial institutions specialized for small firms finance, typically we can see it in Japan. Needless to say, financial institutions compete with each other for small customers and it means a new horizon for small firms has just broken.

As a result, the development of junior markets itself is concerned to the very limited number out of all small firms, but has a great influence on their future because of "a push-out effect" from the top. There is an opportunity that small firms change from marginal borrowers to continuous customers of banks.

Finally lets conclude this paper, pointing out the present problems of junior markets.

The price fluctuation is especially big as shown in several figures. Although a speculation is an essential element for a smooth function of securities market, junior markets, junior as it is, is very likely to fluctuate; rise and fall by even a small speculation.

The second point is a lack of liquidity in junior markets. All authorities set the minimum percentage of floating stocks at the opening up to as much as 10% to 20% of all issued shares, and it contributes to keep the independence of small firms, but also to prevent a satisfactory level of liquidity. At the present, both of investors and the amount of money poured into junior markets are relatively short to sustain its development. The circumstances under which more investors can join junior markets must be arranged as soon as possible. We should push forward with the movement of junior markets as a part of policies of the small firms promotion movement. Because the vitalization of small firms seems to be a short cut to a revitalization of our stagnated economy.

Notes

1) NASDAQ already linked with SEAQ in London also is scheduled the linkage of SESDAQ in Singapole. Investors can look prices of NASDAQ shares in London without the delay of time and the same can be done in America.
2) The Article 163 changed to the Article 535 under the new regulation.
3) Geregelter Markt was launched in 1987, 1, May to be intended to replace Geregelter Freiverkehr and until 30 April 1988 all stocks of the latter had to select to move Geregelter Markt, where 73 shares and two foreign shares are traded at the end of 1987. Almost all of 75 firms moved from Geregelter Freiverkehr but it is worth to note that 10 firms opened newly to Geregelter Markt.
4) Y. Hamada, *Daisan no Shokenshijo* (Junior Markets in the World), 1988, Toyokeizai.
5) Peat Marwich MacLintock's, *USM Survey 1988 December.*
6) The first stage of "Venture Capital Boom" in Japan was described in my next paper, 'Venture Business Boom in Japan', *Hokudai Economic Papers*, Vol.13, 1983−84.
7) In the case of Britain, big banks (so-called "Big Four") competed with each other to develop new types of loans specialized for small firms since the beginning of the 1980's. More detail I described in the next. Small Business Policy in the United Kingdom', *Hokudai Economic Papers*, Vol.15, 1985−86.

Table 1. *Worldwide Development of Junior Markets*

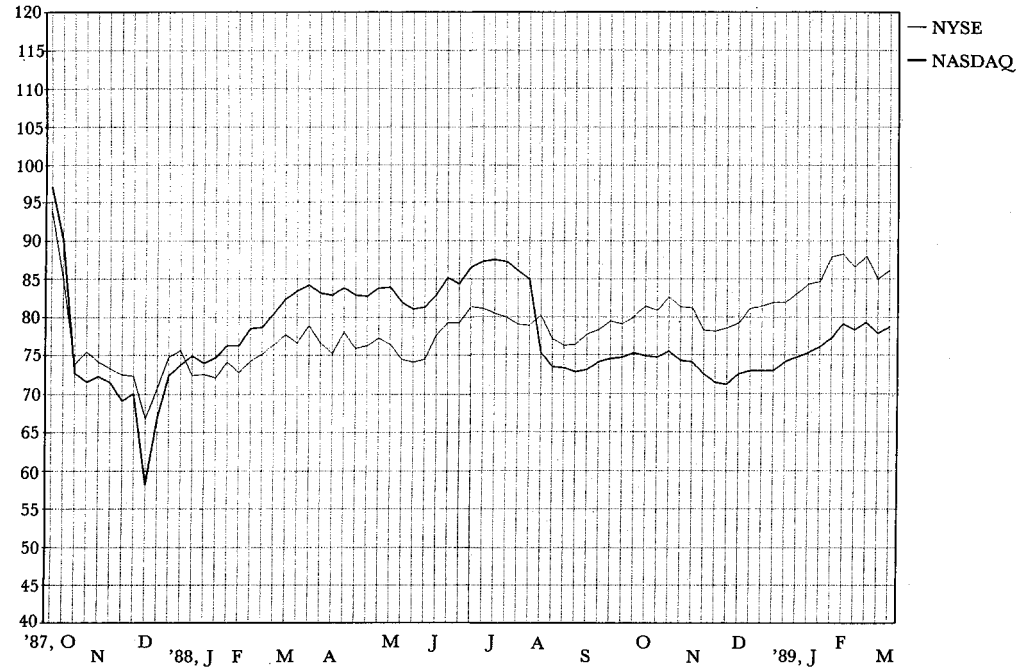
1971	NASDAQ in U. S. A.
1972	OTC of Nightingale Co. in U. K.
⋮	⋮
1977	Special Compartment of Hors Cote in France
1978	Mercato Ristretto as Official Second Market in Italy
1981	Unlisted Securities Market in U. K.
1982	Parallel Market in the Netherlands
	NASDAQ National Market in U. S. A.
	OTC in Sweden
	Drittmarkt in Denmark
1983	OTC in Japan
	Second Marché in France
1984	NASDAQ : SOES in U. S. A.
1985	Bourse II in Norway
1986	New London Bridge in U. S. A. & U. K.
	The Second Tier Market in Spain
1987	SEAQ : SAEF in U. K.
	The Third Market in U. K.
	SESDAQ in Singapore
	OTC in Korea
	Geregeter Markt in West Germany

Table 2. *1986 MARKET VALUE OF NASDAQ COMPANIES*
(At the end of 1986)

	NASDAQ/NMS		OTHER NASDAQ		ALL NASDAQ	
Market Value	Number of Companies	Market Value ($ billions)	Number of Companies	Market Value ($ billions)	Number of Companies	Market Value ($ billions)
$1 Billion or more	37	$60.9	2	$2.7	39	$63.6
$500 M to less than $1 B	82	58.7	3	2.1	85	60.8
$250 M to less than $500 M	188	64.9	9	2.7	197	67.6
$125 M to less than $250 M	294	53.2	21	3.4	315	56.5
$75 M to less than $125 M	314	30.4	30	2.9	344	33.3
$50 M to less than $75 M	297	18.2	49	3.1	346	21.3
$25 M to less than $50 M	528	18.8	151	5.2	679	24.0
Less than $25 Million	860	11.6	1,552	10.6	2,412	22.3
Total	2,600	$316.7	1,817	$32.7	4,417	$349.4

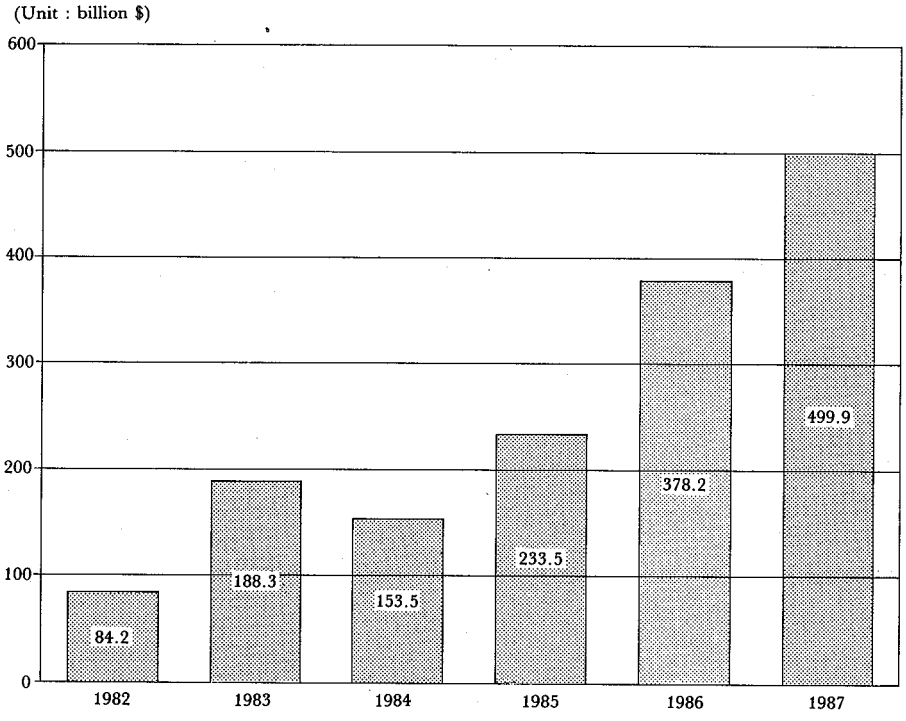
Source : The NASDAQ Handbook.

Fig. 1 *Average Share Prices of NYSE & NASDAQ*



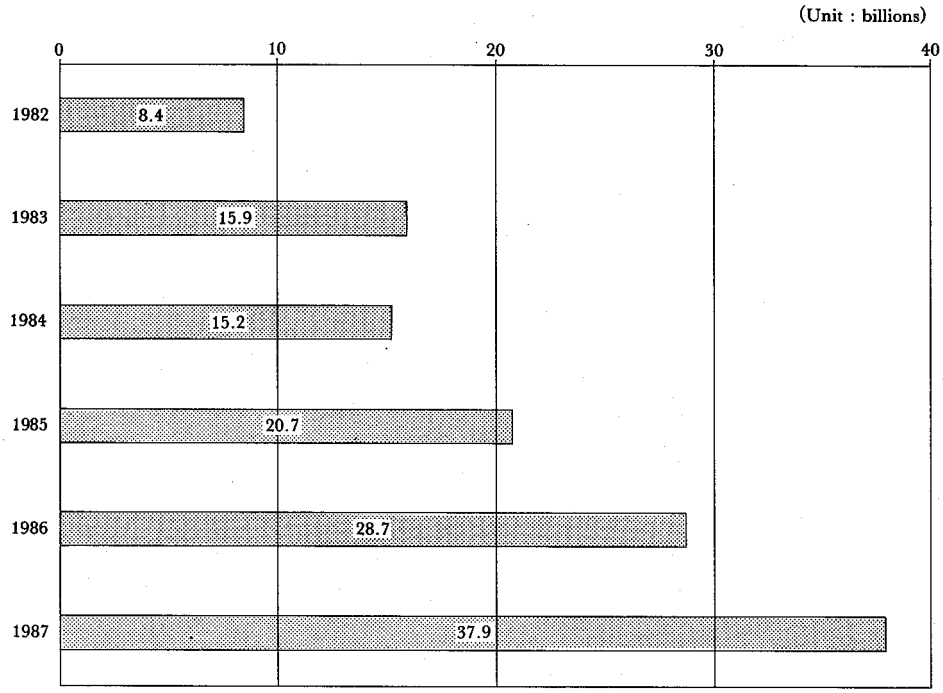
Note : Index : 100 = 1987, 16 Oct.
Source : Nikkei Newspaper

Fig. 2 *Dollar Volume of Equity Trading in NASDAQ*



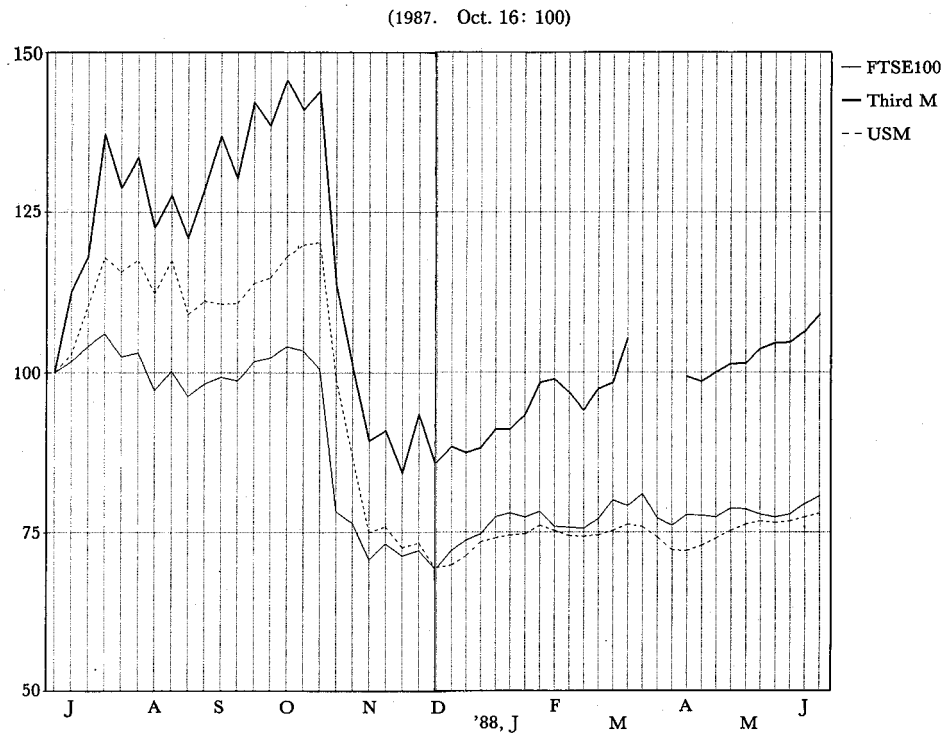
Source : The Asian Wall Street Journal.

Fig. 3 *Annual Share Volume of NASDAQ*



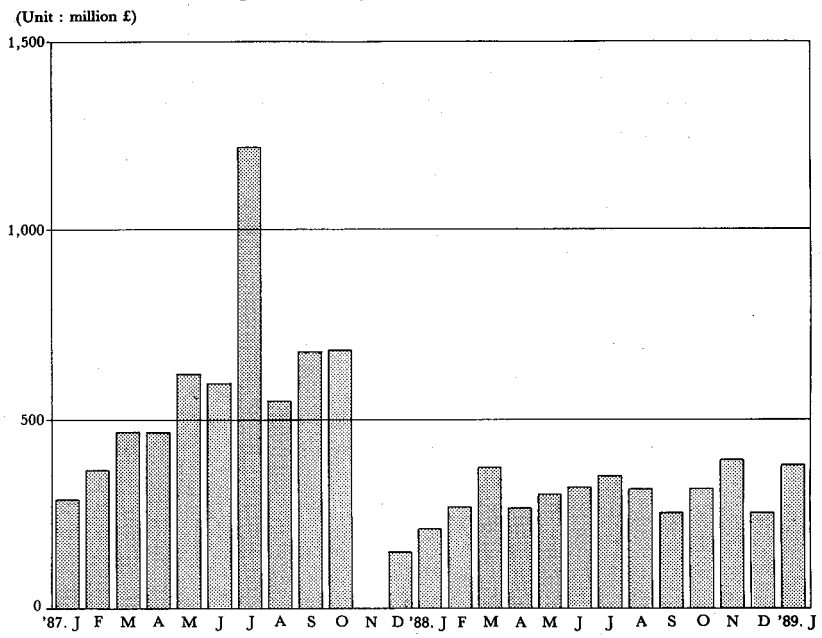
Source : NASDAQ FACT BOOK 1988.

Fig. 4 *Average Share Prices of Three Stock Markets*



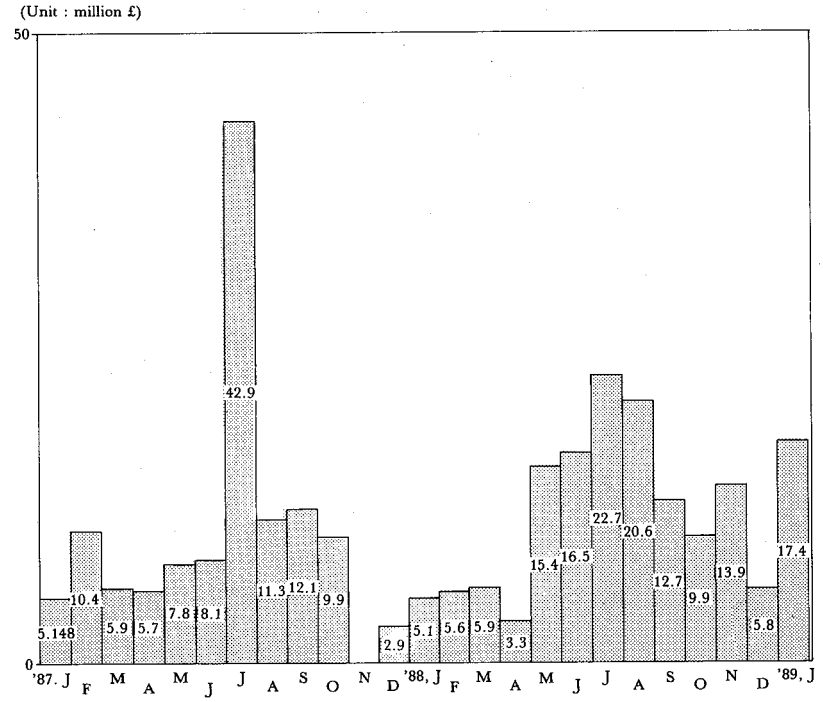
Source : The Financial time, Credit Swiss & Bookmaster.

Fig. 5 *Monthly Turnover of the USM*



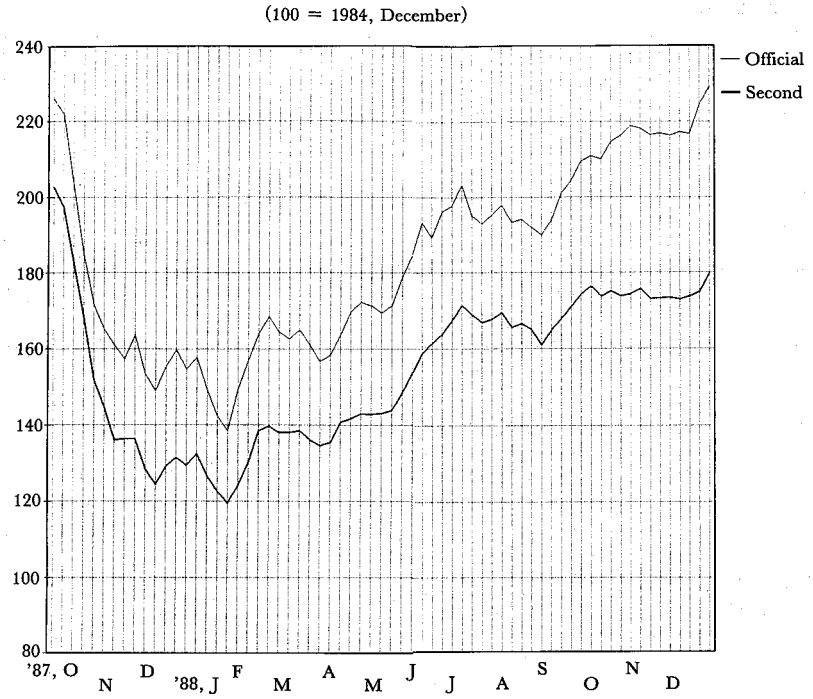
Source : The International Stock Exchange Fact Sheet.
Note : The Data of 1987 Novermber is not avairable.

Fig. 6 *Monthly Turnover of the Third Market*



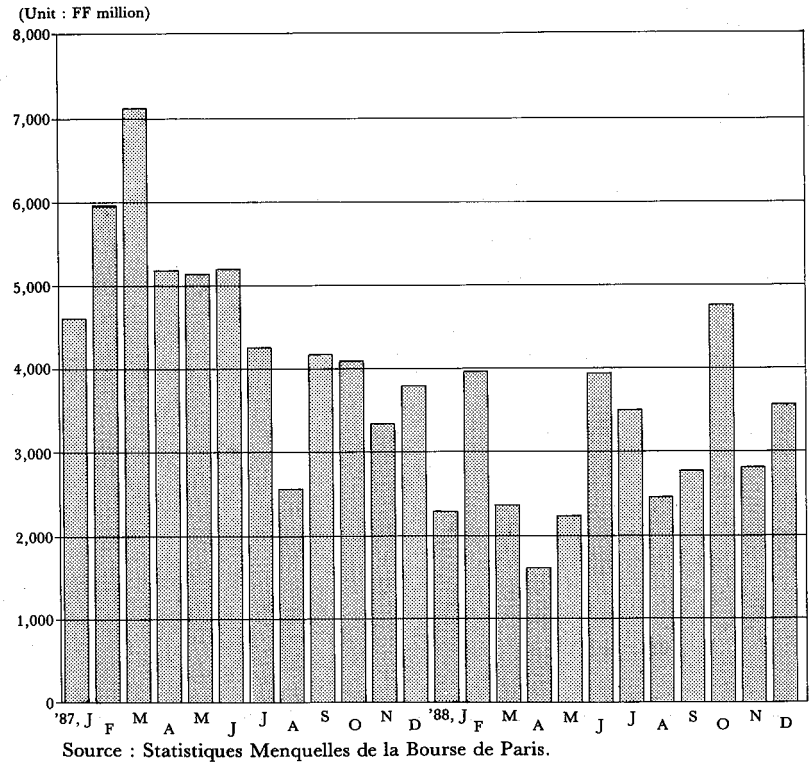
Source : The International Stock Exchange Fact Sheet.
Note : The Data of 1987 November is not avairable.

Fig. 7 *Average Stock Prices of the Official Market & the Second Market of Paris*



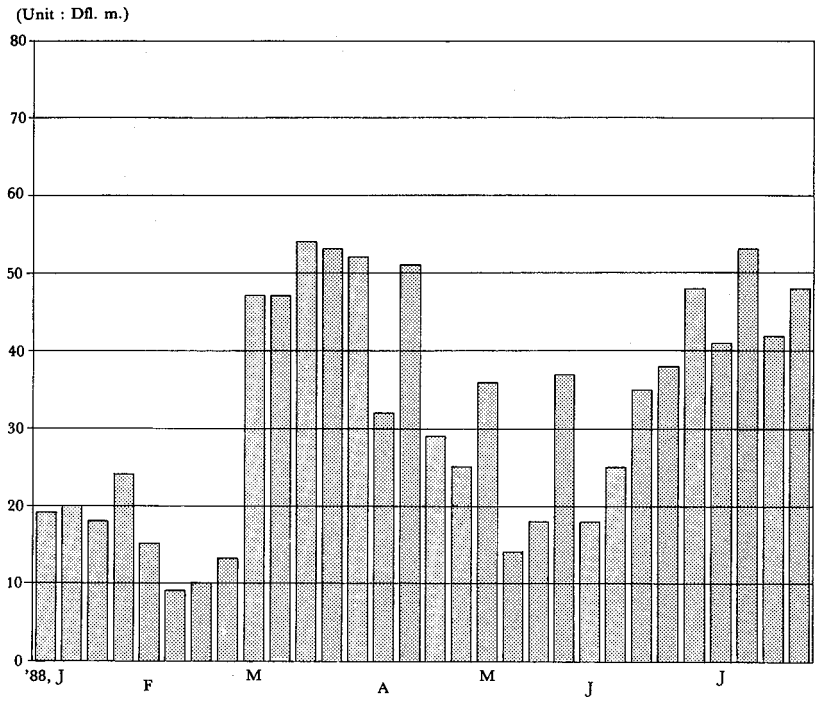
Source : Statistiques Menquelles de la Bourse de Paris.

Fig. 8 *Monthly Turnover of the Second Market of Paris*



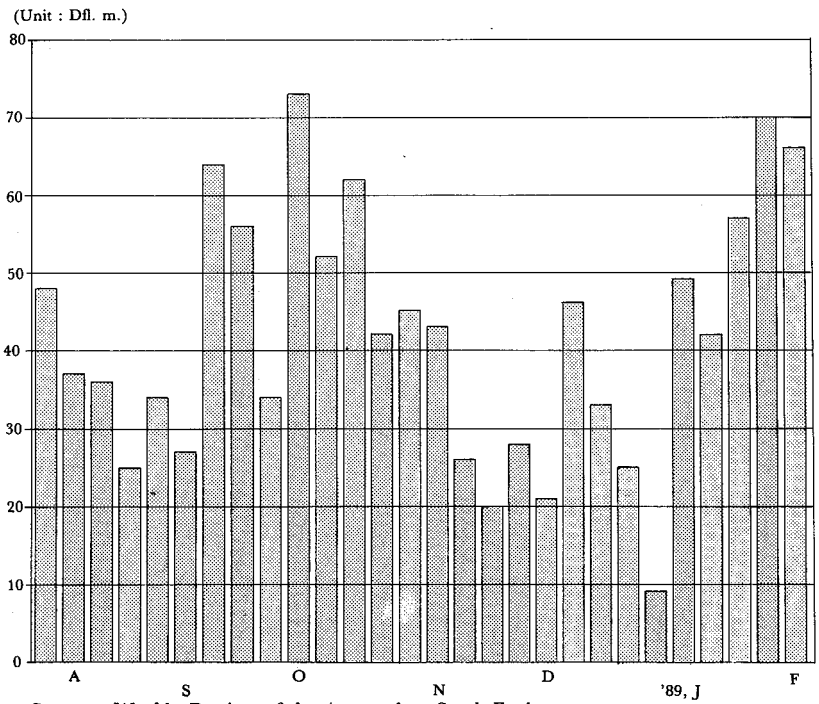
Source : Statistiques Menquelles de la Bourse de Paris.

Fig. 9－1 *Weekly Turnover of the Parallel Market of Amsterdam*



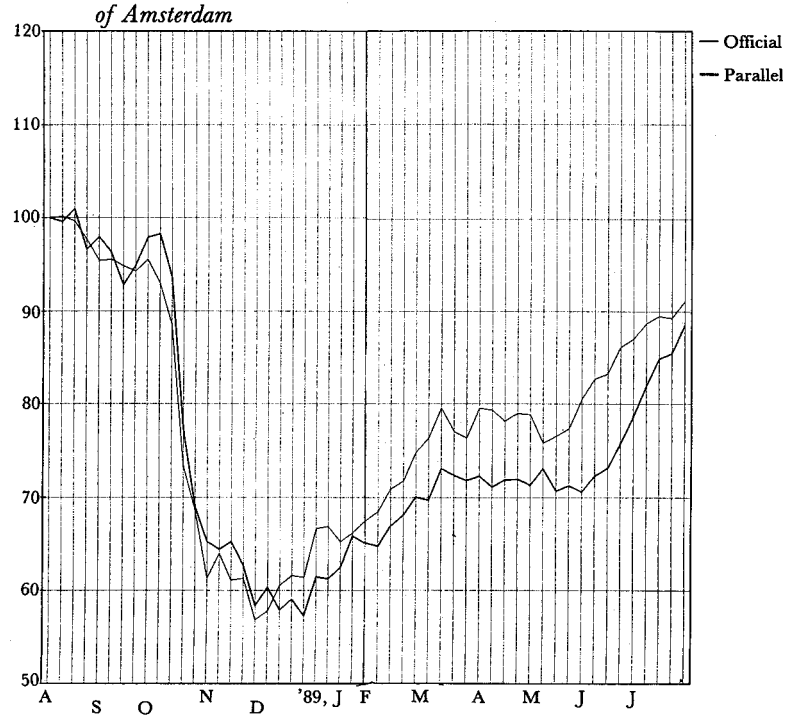
Source : Weekly Review the Amsterdam Stock Exchange.

Fig. 9－2 *Weekly Turnover of the Parallel Market of Amsterdam*



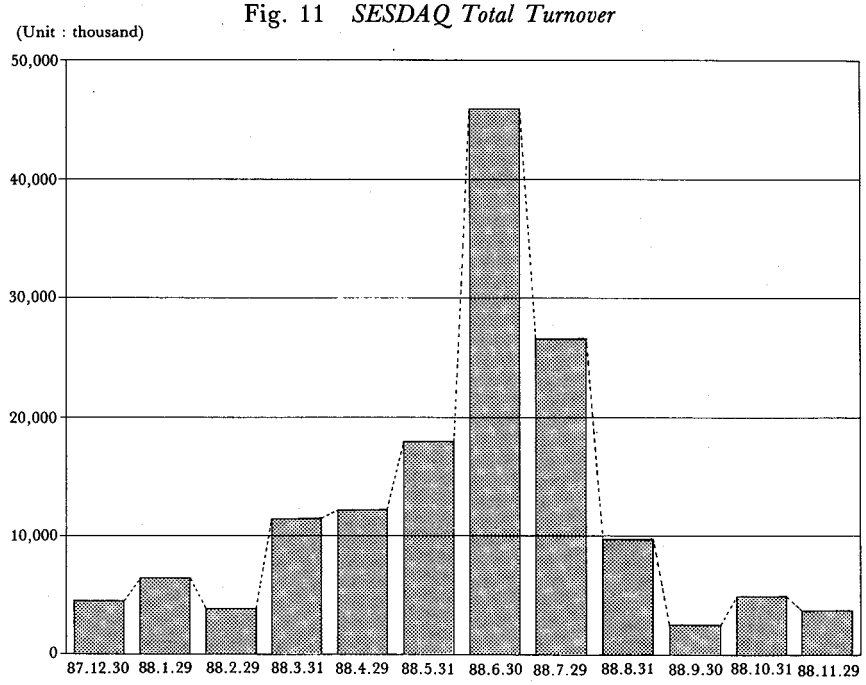
Source : Weekly Review of the Amsterdam Stock Exchange.

Fig. 10 *Average Share Prices of the Official Market & the Parallel Market of Amsterdam*



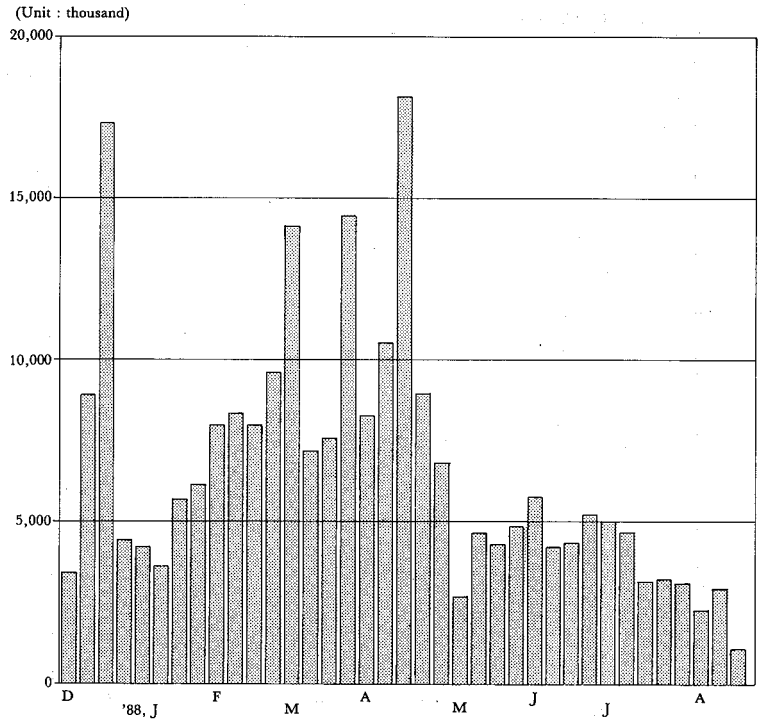
Note : Index 100 = 1987, 7 August
Source : Weekly review of the Amsterdam Stock Exchange

Fig. 11 *SESDAQ Total Turnover*



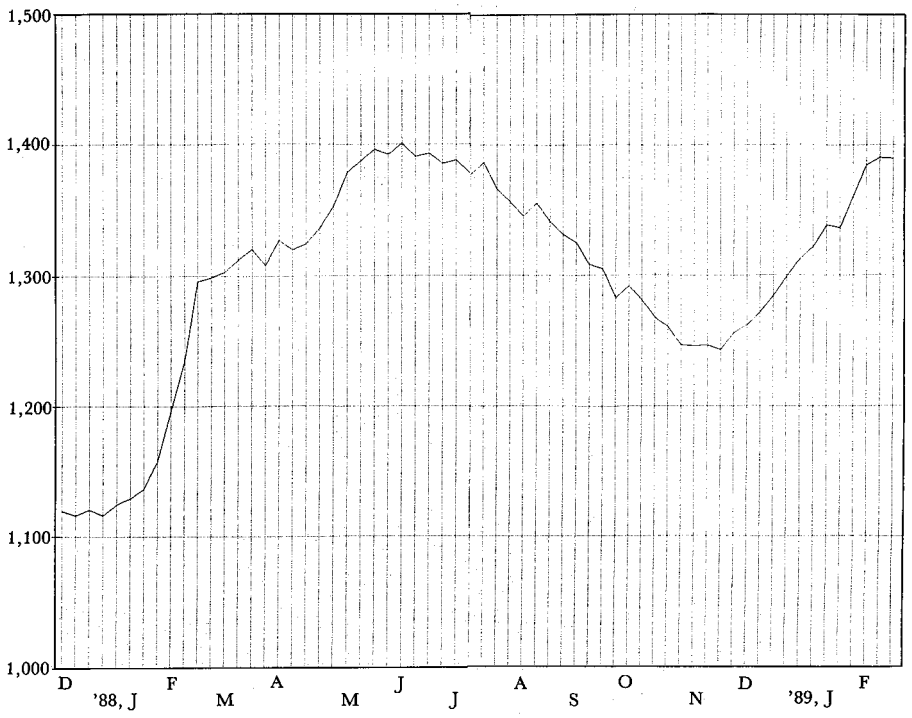
Source : SES Journal.

Fig. 12 *Weekly Share Volume of OTC Market in Tokyo District*



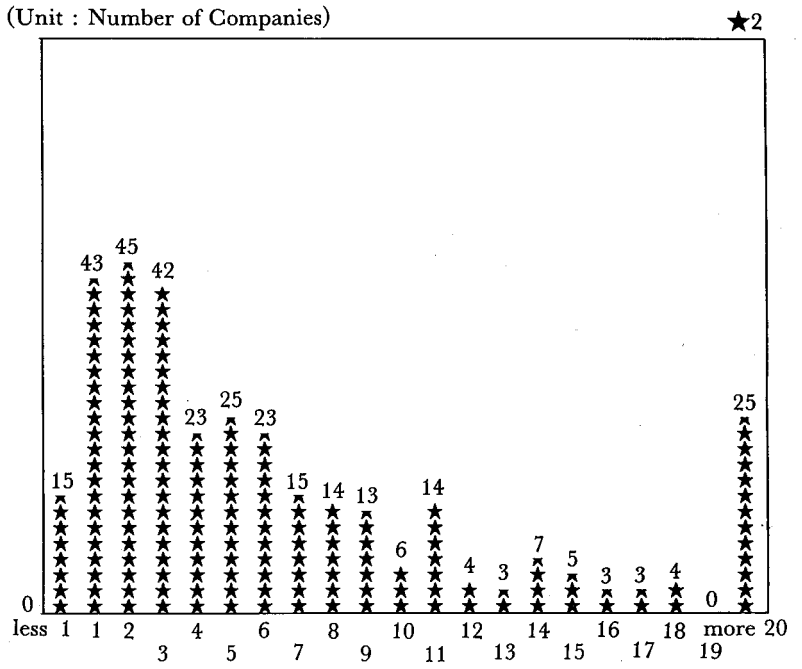
Source : Nikkei Newspaper.

Fig. 13 *Average Share Prices of OTC of Tokyo District*



Source : Nikkei Newspaper.

Fig. 14 *Turnover of USM Firms*



Notes

1) Excluding American and Irish Firms.
2) Turnover is calculated when firms entered into USM.

Source : Peat Marwich McLintock's USM Survey (December 1987).