Encouraging small listings in the DSE

There has been several efforts made by policy makers and other SMEs stakeholders in this country to address financing challenges that are facing Small and Medium sized businesses i.e. some of these initiatives have included introduction of special windows among banks and financial institutions that focuses on financing SMEs, introduction and growth of microfinance institutions targeting SMEs for financing, the SMEs Credit Guarantee Fund sitting at the Bank of Tanzania that guarantees banks' lending to SMEs, etc. They key question at this moment is: are these efforts and initiatives assisting in sustainably addressing the long term capital gap in the small to medium scale manufacturing enterprises, small to medium sized mining projects, medium-scale commercial agricultural projects, or medium sized gas exploration firm, or medium sized contractors in the mining, oil and gas sector or medium sized contractors in the infrastructure or housing projects?

Untill November last year, we were still looking for a breakthrough in the (sustainably) financing of small, economically productive fast-growing firms – such as those participating in the natural resources, agriculture, mining, oil and gas, manufacturing, construction sectors, etc. Until then, there have been neither pre-revenue IPOs nor investment in medium-sized businesses financed by new share issues, leaving some of the country's most innovative and fastest-growing firms in key sectors of our economy such as agriculture, manufacturing, mining, energy, infrastructure, etc without a source of appropriate finance.

Part of the policy and market response to this problem has been the establishment of the Enterprise Growth Market (EGM) in the Dar es Salaam Stock Exchange, in which listings from small and medium firms would attract fiscal incentives for both the issuers and investors – zero capital gain tax, 50% tax relief on dividends payments, 100% off listing related costs and a corporate tax rate of 25%.

This tax incentive regime is at the heart of encouraging small and medium sized businesses listings but there is more to this initiative. Issuers in the EGM also need to make a formal appointment of a mentor to advise their boards on governance and compliance issues – and far from objecting to this intrusion, companies have appreciated the guidance and expertise that mentors bring. These mentors are technically known as Nominated Advisers (NOMADS).

Over its few months of operation, the DSE's EGM has been a resounding success, with 2 listing approvals and 2 applications being considered at the time of writing. The early success of the DSE's EGM should be something of a catalyst for developments in our mid sized business enterprises growth in particular, and the overall economic development of our country.

Facilitating SMEs' access to the capital markets is not, of course, a new aspiration and nor did it originate with the success of the main investment market experiment; or any peculiar Tanzanian experience, in fact, alternative, small cap market segments for the SME's financing through stock exchange is a common phenomenon, is not unique for Tanzania only. Well established capital markets have used this approach to grow their mid-sized companies i.e: London's AIMs has more than 3,000 companies, NYSE's Altenext has several thousand companies listed, Japan's (Market for High-growth & Emerging Stocks – MOTHERS has 192 companies, Malaysia's ACE Market has 109 companies, Hong Kong GEMs market has 267 companies, Italy's AIM: 28 companies, Brazil's Nova Mercado also has several companies listed in this segment. Other African countries with similar model & experience are: South Africa's Altx that has 80 companies, Mauritius's DEM has 48 companies, Nigeria's ASeM has 9 companies, Kenya's GEMs has 1 company, Egypt's NILEX, Ghana's GAX also has several companies listed.

EGM, as a second-tier market, is targeting companies with capitalisation of less than TZS 500 million. As commonly is with other markets, as we motivate and encourage SMEs to fill in their long term financing needs through listing into the Exchange, we understand that public scrutiny represents for would-be issuers with a cultural challenge – i.e. coming to market, opening up their books, dealing with full disclosure and transparency is a big deal for entrepreneurs. Without [any added] incentive one might argue, entrepreneurs and SMEs owners don't think there is a sufficiently large 'carrot' to pull them on board. So what other similar countries have done, let me give the examples of the Trinidad & Tobago Stock Exchange (TTSE) and Jamaican Stock Exchange (JSE) that have recently launched their own junior markets.

In the JSE listings from small firms attracts significant fiscal incentive – i.e. zero income tax for five years after listing, 50% tax relief for the following five, 50% off fees and complete tax relief on dividend payments, all on the condition that the issuer would not delist within 15 years.

Recently, in one of the budget speeches, the Minister of Finance, Planning and the Economy for Trinidad & Tobago had this to say "…*our small and medium enterprises continue to be over-reliant on bank financing.…we will work with the Trinidad and Tobago Stock Exchange to create a third tier on the Exchange to provide Small and Medium Enterprises with access to the capital market.*

…for the first 5 years SMEs whose capital is greater than $5 million but less than TT$50 million and listed on the SME Market for trading purposes would be allowed a 10% corporation tax rate. The SMEs would be required to raise capital on the stock exchange through an initial public offering with a minimum of 25 shareholders holding at least 30% of the company's share capital. This initiative will be reviewed every five years. We expect this tax incentive regime to encourage small and medium-term enterprises to access resources from the capital market".

So, fiscal incentives have been considered as a key attraction for SMEs to consider raising capital through public money. Another key challenge for SMEs is the whole question of governance. For us, there has been and would be no intention of relaxing disclosure and assurance requirements as a means of encouraging SME listings – the EGM impose on issuers the same obligations for regular reporting and assurance as does the main board. The rationale is simple. If you ask people to invest in a risky class of assets like SMEs, they have to know what they're investing in, and therefore it is essential that there have to be full disclosure.

The DSE's EGM will soon have its second pre-revenue IPO – pre-revenue IPO is also a challenge. In this regard, our focus has been/is on high-quality, high-profile listings that can inspire trust in the market. In a normal situation, a typical preferable EGM listing would be from an already well-established firm, usually owned by a single family or business group, with significant growth plans. What is key even for such ideal listings, EGM companies have to be informationally transparent, must have at least two independent board members, and must have 20% of their shares distributed among at least 100 owners. Not all would-be issuers are willing or able to conform to these requirements, but we remain confident that, once a company is convinced of the benefits of listing, market discipline will work alongside regulation to ensure governance is taken seriously.