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Bucharest Stock Exchange Financing Opportunities for Romanian IT SMEs

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Abstract. *The paper presents the current development status of the Romanian capital market and the opportunities it offers for small and medium enterprises (SMEs) to finance their growth strategies through the stock exchange. It is well known that SMEs represent a growth engine for any economy in terms of contribution to GDP, employment rate, and tax contribution to the state budget. Their primary role of supplying goods and services dynamises the market landscape and creates the proper context for competition, innovation, and research and development. However, in this context, they are the most affected by the economic crisis, inflationary pressures, post-Covid uncertainties, and the war in Ukraine. Thus, their access to finance is now more important than ever. The paper's focus is on SMEs from the Romanian information technology (IT) sector and how their growth since listing could be a driver for other Romanian IT companies to list on the Bucharest Stock Exchange. The stock exchanges offer SMEs medium and long-term financing opportunities, regardless of market conditions. Therefore, the more successful the SMEs business, the more significant their role as an economic growth engine is. The research is based on a quantitative approach-content analysis provided by Bucharest Stock Exchange and local and international financial institutions. The SMEs' performance profile is determined by using trading evaluation indicators for IT SMEs listed on the Exchange. Results show that, by listing, companies benefit from contextual market conditions, highlighting the recommendation for other companies from the IT sector to list their business on the stock exchange.*

Keywords: capital markets, SMEs, technology, Romania.

Introduction

Bucharest Stock Exchange is the reference public equity exchange in Romania. With a market capitalization of EUR 43bn and an equity daily average turnover of EUR 10.85m at the end of 2022, the Bucharest exchange is among the medium-sized stock exchanges in Central and South-Eastern Europe. In 2014, in its efforts to be upgraded from Frontier to Emerging Market status by global index providers and gain the related benefits from exposure to more foreign investors, the Romanian capital market started a journey of domestically implementing relevant international best practices. Thus, measures were taken to improve infrastructure, market accessibility, and

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increase liquidity by attracting more companies to list. Therefore, in September 2016, FTSE Russell included Romania on the watchlist of Emerging capital markets, with the effective upgrade taking place in September 2020.

Since 2015, 9 private companies ran public offers on the Bucharest Stock Exchange regulated market (main market), attracting EUR 548m from the market. In parallel, 38 companies got listed on the multilateral trading facility of the Exchange (AeRO), the junior market segment dedicated to small and medium companies. Out of these, 2 went public through an initial public offering and 32 through private placement, raising a total of EUR 82.69m from the market; the other 4 companies opted for a technical listing. The AeRO market is an alternative financing place with listing criteria adapted to small and medium companies, making the marketplace easily accessible, which creates a pipeline for future listings on the main market.

To attract new listings on its markets, the Bucharest Stock Exchange has made various supporting mechanisms available to companies. These mainly refer to accessible listing criteria and a smooth document flow, a networking and development platform offered by the Made in Romania program, and advisory support via an authorized advisor or a liquidity enhancement mechanism via the issuer's market maker institution. As MiFID considerably restricted listed company coverage, to improve investors' access to quality information about such companies, Bucharest Stock Exchange launched the BVB Research Hub. This is a platform hosting research reports prepared by the analysts of those investment firms trading on the Romanian market, peer comparison by valuation multiples, and ESG Scores provided by Sustainalytics. Also, as of January 2023, a new platform section is dedicated to third-party contributors. These are retail investors who would like to present general non-commercial information about listed companies and capital markets on the platform. Bucharest Stock Exchange is also a partner of the Romanian Investor Relations Association, which has a defining role in increasing awareness of the necessity of a good investor relations activity for enhancing the market performance of a listed company. Since 2019, the Association has also compiled a yearly corporate governance quality reporting index for companies listed on the main market of the Bucharest Stock Exchange. The index is called VEKTOR and is based on a well-defined methodology. The index is publicly available on the Bucharest Stock Exchange website and, as of 2022, the index is also computed for the most liquid companies listed on the AeRO market (those stocks that are part of the BETAeRO index). Also, on the side of applied corporate governance for capital markets, a tailored training program for board members and C-level executives, called the Effective Board Director Program, is made available by ENVISIA-Boards of Elite.

The market segments managed by Bucharest Stock Exchange are home to listed companies from a wide range of sectors. Nevertheless, as information technology is one of Romanian economy's most dynamic and sustainable sectors, the present paper will focus on it. As per the Eurostat main database, ICT (information, communication and technology) sector represented 3.74% of Roman ia's GDP in 2019 (the most recent data available for comparison), increasing from previous years but still below the EU average figure of 4.89% of GDP, showing its potential for further growth. For the same reference year, the personnel employed by the ICT sector represented 2.63% of the total employment in Romania, significantly growing from year to year but slightly below the EU average of 3% in 2019. The number and scale of companies active in the ICT sector in Romania are increasing (Eurostat, 2023; Employers' Association of the Software and Services Industry cited in Romania-Insider, 2022; National Bank of Romania, 2022), creating a high degree of competitiveness. Most of them are owned by non-residents, and their services go mainly to export. But there is also an increasing sector of Romanian entrepreneurial business, very innovative

and dynamic, which raises the image and the brand of the local ICT sector. Digital transformation has recently been seen as a global factor impacting economies and businesses and is considered a growth factor for the ICT sector.

The listing is defined as the process through which a company attracts financial resources from the public market, capital markets, for financing its medium and long-term growth. As SMEs represent the most dynamic component of an economy, there have been a lot of global initiatives to facilitate their financing through existing mechanisms and to develop new, easily accessible mechanisms. As of the end of 2022, 13 companies from the ICT sector (Romanian CAEN classification) had shares listed on the Bucharest Stock Exchange. Out of these, 12 were from the IT services subsector (Romanian 62 class CAEN classification) and 1 from the cinema, video and TV production subsector (Romanian 59 class CAEN classification). These 12 companies from the information technology subsector are subject to analysis in the present paper.

Literature review

SME financing through capital market

There is a lot of literature about financing alternatives for SMEs, especially in the wake of the economic crisis (Allotti, V., Bianchi, M. and Thomadakis, A., 2021; Boot, A., Carletti, E., Kotz, H.-H., Krahnen, J.P., Pelizzon, L., and Subrahmanyam, M., 2020b; Lannoo, K. and Thomadakis, A., 2020; Peterhoff, D., Romeo, J., and Calvey, P., 2014; Schellhase, J. and Woodsome, J., 2017).

"Multi-tiered markets have been increasingly important in providing a viable option for SMEs to access market-based financing while addressing the demands of various parties. For example, by providing SMEs with specific entry and regulatory requirements tailored to their characteristics at lower listing cost compared to the main market as well as acting as a liquidity provider with a wider investor base on a transparent and compliant platform." (IOSCO, 2015) "The development of stronger capital markets in Europe, in particular, the fostering of equity financing, could overcome some funding constraints stemming from overreliance on banking, address the issue of over indebtedness of parts of the EU corporate sector and provide for healthier transfer sharing of risk across member states" (Allotti, V., Bianchi, M. and Thomadakis, A., 2021). Same authors expressed that "equity financing offers an important alternative for growth-oriented SMEs to raise capital, given that these firms tend to depend on more difficult-to-value intangible asset" and that "small IPO markets could incentivise investment in SMEs and, alongside securitisation and other non-bank debt financing instruments, could improve the allocation of risk and risk taking, thus supporting growth." Also, Peterhoff, D., Romeo, J., and Calvey, P., 2014, wrote that "issuing equity and debt securities can provide SMEs with the stable, long-term financing that bank lending typically does not. Because these securities are tradable, their prices provide information about the performance and value of the SMEs concerned." and, "by encouraging more SMEs to start up and to expand, SME capital markets stimulate economic growth and job creation".

As capital markets are generally a highly regulated space, the literature review for the present paper also covers the legislative initiatives and opinions coming from the capital market institutions and decision factors.

SMEs form the central pillar of the Capital Market Union (CMU) action plan, launched by the European Commission in 2015. The CMU is expected to "provide businesses with a greater choice of funding at lower costs and provide SMEs in particular with the financing they need" (European Commission, n.d.). In December 2022, the European Commission adopted a new legislative proposal regarding listing, with the primary purpose "to alleviate – through a new Listing Act – the administrative burden for companies of all sizes, in particular SMEs, so that they

can better access public funding by listing on stock exchanges," but "without jeopardizing investor protection and market integrity" (European Commission, 2022). The new legislative proposal covers mainly four topics: simpler prospectus rules, more proportionate market abuse rules, multiple-vote shares structure, and SMEs investment research. The benefits brought by the piece of legislation translate into cost reductions and more listings through an IPO. For investors, the benefits come from easy and timely access to corporate information, while for market supervisors it will be a more efficient process.

In the works of the 2022 EUROFI Forum on the Listing Act, the importance of SME financing was discussed in the context of EU capital markets which are limited in size and where investors are more risk-averse than in other geographic markets. The limitation in size comes mainly from market fragmentation because capital availability exists through large savings and interest in investing in SMEs. The speakers mention a EUR 300-600bn financing gap, based on reports assessed during the pandemic by International Monetary Fund and the Association for Financial Markets in Europe, and that "most companies increased their level of indebtedness during the pandemic." "The higher interest rates will also increase funding costs, further widening the funding gap." Speakers also discussed the global market changes that will positively affect the SMEs' business growth in the next period, growth for which SMEs need financing. These changes come from redesigning the supply chain, digitalisation, and transformation toward sustainability and green projects. Taxation, macroeconomic environment, and capital market support measures from the authorities were also mentioned among the factors determining equity market growth.

IOSCO (2015) states "Proportional regulation would lessen the regulatory burden on SME issuers. Particularly important would be to increase the availability of relevant information on SMEs in order to help investors make informed decisions."

In its Capital Market Review of Romania (2022) the OECD states that "the Romanian corporate sector is over-reliant on bank financing and a large share of firms remain credit constrained. Market-based financing can help fill the financing gap while increasing financial resilience in the corporate sector by supporting viable businesses and reducing the period needed for recovery. A well-functioning capital market will ensure access to different sources of financing which will be essential to foster sustainable economic development in Romania." To support the listing of SMEs on AeRO, OECD recommends a subsidy program to help prepare the documentation needed for a company's listing. In line with this, on January 3, 2023, the Ministry of Investments and European Projects launched a public consultation on The National Recovery and Resilience Plan (PNRR): The draft guide related to the grant instrument for the listing of companies on the stock exchange. The project, part of PNRR, has a budget of EUR 35m which will be allocated on a "first come, first served" basis. The activities covered by the project refer to legal, fiscal, audit and listing fees, as well as advisory on governance, investor relations, and sustainability reporting.

Methodology

This paper makes use of a quantitative and descriptive methodological approach. The authors employed descriptive statistics and content analysis to examine primary and secondary data extracted from the database of the Bucharest Stock Exchange. This includes up-to-date information and data sets for financial instruments traded on its markets, market indices, and valuation indicators for financial instruments. As attracting companies to list on its markets is central to the Bucharest Stock Exchange strategy, the Exchange makes information about all its projects and activities publicly available. Therefore, the data and content provided form the basis for the data

collection and analysis in the present paper. The data analysis was performed in Microsoft Excel software.

The purpose of this study is to analyse the evolution of the financial indicators of the IT Romanian companies listed on Bucharest Stock Exchange, in order to identify and advance possible strategies for their advancement on the Romanian market.

The present paper analyzes a sample of 12 Romanian companies from the IT sector, listed on Bucharest Stock Exchange. The authors selected these companies because the IT sector showed high growth in recent years in Romania and the digitalization transformation is a factor that will further impact businesses. From the 12 IT companies listed on the Bucharest Stock Exchange, the authors selected all of them for the present analysis.

Considering that an increasing part of the Romanian IT sector consists of entrepreneurial businesses, which for their future development might need savvy, active and involved professionals and investors, the present paper focuses only on financing through the listing of shares (public offers and private placements), which is the mechanism that such investors prefer.

For these companies, the paper analyses their trading history on the market (by type of market and number of years since listing), size (market capitalization) and valuation metrics (book value, price per book value, price per earnings, and dividend yield). The purpose of the analysis is to find relations between their trading history, size and valuation metrics in order to estimate potential transfers of IT-listed companies from the AeRO market to the regulated market and, by the increased visibility of the sector on the market, to attract even more IT companies to list on the exchange.

Results and discussions

The 12 IT companies listed on the Bucharest Stock Exchange, which form the subject of the present paper, are presented in Table 1:

Table 1. Trading valuation indicators for IT SMEs listed on Bucharest Stock Exchange

No.	Company	Listing market segment	Start trading date	Years since listing/ Tenure on the exchange
1	Bittnet Systems	Main market	3 Jun 2020	2+
		AeRO	15 Apr 2015	5+
2	2B Intelligent Soft	AeRO	16 Mar 2022	1-
3	2Performant Network	AeRO	9 Dec 2020	2+
4	Arctic Stream	AeRO	29 Jul 2021	1+
5	AROBS Transilvania Software	AeRO	6 Dec 2021	1+
6	Ascendia	AeRO	7 Jul 2016	6+
7	Connections Consult	AeRO	29 Sep 2021	1+
8	Firebyte Games	AeRO	6 Apr 2021	1+
9	Gocab Software	AeRO	9 Dec 2021	1+
10	Life is Hard	AeRO	8 Dec 2015	7+
11	Safetech Innovations	AeRO	29 Ian 2021	1+
12	Softbinator Technologies	AeRO	17 Dec 2021	1+

Source: Bucharest Stock Exchange, www.bvb.ro, January 2023.

All these companies started trading on the AeRO market of the Bucharest Stock Exchange, while Bittnet transferred to the main market in 2020. As per BVB press release at that time, during its five years on AeRO market, the company's market capitalization increased 23 times. The company used the capital markets mechanisms, attracting several rounds of financing through corporate bond issuances and share capital increases of approx. EUR 12m. Moreover, the company maintained a permanent communication with its investors and a good investor relations activity. The transfer on the main market of the stock exchange offers to company the opportunity to access a broader range of institutional investors, both local and foreign, which would otherwise have had restrictions to invest in an AeRO stock. Also, the company benefits from research coverage by equity analysts from Ipopema and Wood & Company. The company's shares are included in the local market indices BET-BK, BET-XT, and BET-XT-TR, but also in the FTSE Russell Microcap Index. The Bittnet 2020 Annual Report states that "listing on the Bucharest Stock Exchange […] allowed us to obtain an appreciated employer profile and helped us differentiate ourselves as an open and transparent company - an image highly appreciated by all new and old employees."

Bittnet is the market training leader in Romania and, since listing on Bucharest Stock Exchange, the company has run an active growth strategy, also supported by an ongoing M&A activity. By acquiring companies such as Gecad NET, Crescendo, Elian, Equatorial, Top Tech, and 2Net, Bittnet has become an IT integrator.

By analysing the data inTable 1, one can see that companies listed on the AeRO market are quite recently listed. Taking into consideration that Bittnet needed more than five years to transfer to the main market, it can be expected that companies with the longest AeRO listing history to be the first ones to transfer to the main market. It is natural to assume that a company needs a certain number of years to mature from a growth, governance, and investor relations perspective in order to be prepared and eligible to transfer to the regulated market. In this regard, in October 2021 Life is Hard, publicly announced its intention to list on the main market.

Table 2 shows the valuation ratios for the 12 IT companies listed on Bucharest Stock Exchange:

Table 2. Valuation ratios for IT SMEs listed on Bucharest Stock Exchange

Company	Market Capitalization (RON m)	Book Value (RON m)	Book Value Date	PBV*	PER*	PER* Date	DIVY*	Dividend Year
Bittnet Systems	155.9	59.9	30 Jun 2022	2.60	12.69	30 Jun 2022	-	-
2B Intelligent Soft	48.8	11.9	31 Dec 2021	4.08	10.76	31 Dec 2021	2.05	2021
2Performant Network	22.3	6.6	31 Dec 2021	3.35	-31.80	31 Dec 2021	-	-
Arctic Stream	93.9	10.4	30 Jun 2022	8.99	17.08	30 Jun 2022	3.57	2021
AROBS Transilvania Software	851.2	212.8	30 Jun 2022	4.00	19.71	31 Dec 2021	-	-
Ascendia	36.1	6.4	30 Jun 2022	5.63	22.63	30 Jun 2022	-	-
Connections Consult	48.0	15.0	30 Jun 2022	3.20	39.83	31 Dec 2021	-	-

Company	Market Capitalization (RON m)	Book Value (RON m)	Book Value Date	PBV*	PER*	PER* Date	DIVY*	Dividend Year
Firebyte Games	19.1	6.9	30 Jun 2021	2.77	-	-	-	-
Gocab Software	4.2	-	-	-	-	-	-	-
Life is Hard	58.7	38.5	30 Jun 2022	1.52	12.27	30 Jun 2022	0.4	2019
Safetech Innovations	216.1	14.6	31 Dec 2021	14.76	35.10	31 Dec 2021	1.92	2021
Softbinator Technologies	77.0	11.4	30 Jun 2022	6.75	29.27	31 Dec 2021	-	-

Source: Bucharest Stock Exchange, www.bvb.ro, 2022.

Note 1: All indicators presented in the table are computed by the Bucharest Stock Exchange. For indicators in the table that do not have the reference date mentioned, the indicators are computed by Bucharest Stock Exchange based on the end-of-day prices of 23 Jan 2023 and considering the individual financial statements, except for Bittnet Systems, where the consolidated financial statements are used.

Note 2: Abbreviations in the table have the following meaning: PBV-price per book value, PER-price per earnings, and DIVY-dividend yield.

Note 3: The indicators have the following meaning, as per Investopedia: Market capitalization - "a company's market capitalization is the market value of all its shares, calculated by multiplying the price per share by the number of shares issued." Book value – "amount of money shareholders would receive if assets were liquidated and liabilities paid off." Price per book value – "measures company's market value relative to the book value." Price per earnings – "measures company's current share price relative to its per-share earnings."

It can be seen that Life is Hard has a good book value compared to its market capitalization (approx. 65%) and a price per book value at the closest to 1 from among the companies presented, respectively 1.52. With the second lowest price-per-earnings ratio among the companies presented, 12.27, Life is Hard seems undervalued.

The BETAeRO index was launched in October 2021, to reflect the price evolution of the most liquid companies listed on the AeRO market. The index consists of 33 companies, including the 11 IT companies listed on AeRO, that had a total weight of 37.15% at the end of the January 26, 2023 trading day.

Regarding market capitalization, Safetech Innovations and AROBS Transilvania Software are 1.38x, respectively 5.46x larger than Bittnet, their free-float market capitalization in the BETAeRO index giving them the 3rd and respectively the 1st largest weight in the index. Naturally, considering this market indicator, the two companies may also have prospects for transferring on the stock exchange's main market.

On January 26, 2023, Bucharest Stock Exchange announced that the shares of Safetech Innovations, a top provider of cyber security services and solutions, will transfer to its main market as of February 6, 2023.

The overall evaluation of the companies-subject of the present paper reflects the stage of size, growth, and financing needs typically for small and medium SMEs acting in the IT services sector.

To understand the public offering potential for a stock exchange, the PWC Global IPO Watch for 2022 clarifies determinant aspects of the last year's evolution but also for future IPOs. In 2022, the IPO market was influenced by "inflation, central banks' policies and politics", being the worst market evolution since 2016. About the return to IPOs, the report states: "Market

participants, including a backlog of suitable IPO candidates, in the US and Europe, are now focused on a potential H2 2023 recovery of the IPO markets, and whilst some issuers may attempt to tap the market earlier in H1, issuers are dedicating their resources early to prepare for <being public>. This mindset is the key ingredient to a successful IPO as the markets re-evaluate fundamentals".

What concerns the evolution of the IT sector globally, in 2022 was influenced by the "rising interest rates, slowing economic activity, and a normalization of COVID-19-era consumption habits" (Franklin Equity Group, 2022). The same report mentions the optimism towards 2023 as "companies are expected to continue many of their Digital Transformation initiatives, albeit at a slower pace, even in the face of moderating rate increases and slowing economic activity. This is because these investments are driving needed productivity gains, especially in an inflationary environment". Instead, expectations from consumer technology are modest, mainly due to the high and volatile energy prices and slow economic growth. "While the past year has been difficult, we remain optimistic because we continue to see signs of enduring quality, sustainable growth and supportive valuations" (Franklin Equity Group, 2022).

World Economic Forum, in The Global Risks Report 2023, in terms of current technological risk on society, mentions the "cyberattacks on critical infrastructure," the "widespread cybercrime and cyber insecurity," but also "digital inequalities" and the "adverse outcomes of frontier technologies," each of them quantified by severity and timeframe impact. When purely looking at the technological risks, one can easily estimate how much other technological and ethical work needs to be done to handle such risks. Moreover, the potential for innovation and IT business growth derives from this.

The limitations of the present research are mainly quantitative and derive from the current characteristics of the IT sector's representation on the Bucharest Stock Exchange, such as a small number of listed companies and a short trading history. Therefore, this research paper covers all 12 IT companies listed on the stock exchange, which is not entirely representative of the whole range of companies present within the Romanian IT sector; the insufficient sample size also limits the possibilities of statistical measurements.

The paper also presents a qualitative limitation due to the lack of a survey on the internal corporate development status of the IT-listed companies, with the purpose of better estimating the time needed for a company to be prepared to transfer from AeRO to the main market. The results of such a survey can be beneficial both for a stock exchange, to know how to adjust its marketing efforts in order to attract more companies from the IT sector to list, but also for the companies surveyed, in order to know how they position towards the mean and the trends of the sector.

Another limitation of the research comes from the fact that the development of the IT sector in Romania is poorly covered by official sources of data and literature.

Future research directions include a dedicated survey for Romanian IT listed companies, increasing the sample of analyzed companies by extending it to Romanian IT companies that are not listed, expanding the analysis to other industrial sectors in Romania which are represented on the Bucharest Stock Exchange, but also taking into consideration a bigger number of market and corporate valuation indicators.

Conclusion

The authors explored market and valuation indicators for the 12 Romanian IT companies listed on Bucharest Stock Exchange in order to assert their appropriateness for the Romanian market and to suggest future possible strategies for these companies.

The results show that one IT company that transferred from the AeRO to the main market benefited from access to finance its growth through various market mechanisms, improved visibility and better positioning toward employees. A second IT company very recently announced its transfer to the main market; it benefited from increased market awareness by listing, but the benefits related to the market transfer are not assessed and cannot be assessed in the present paper, as the transfer is of very recent date.

Companies need a certain time to grow and prepare to transfer from the junior AeRO market to the main market and it seems appropriate to consider that companies with the longest AeRO listing history can be the first ones to transfer to the main market. Also, the largest AeRO-listed companies by market capitalization and with good valuation metrics can be the next candidates for an upgrade to the main market.

There have been lots of public discussions about how a company can benefit from listing, these being: improved visibility; market awareness; good rating in public/stakeholders' eyes; access to a vast network of retail and institutional investors, index providers and other stakeholders/potential business partners; business process efficiency; improved employees' perception over the company. The existing stories of the already listed IT companies create a precedent and a good example for other peers to follow.

The evolution of the IT sector and the trends reflected by analysts show the likelihood for further sustained development of the sector, which will translate into more active companies in the field, supporting the real economy and increasing its nominal contribution to the GDP. This, cumulated with the fact that Bucharest Stock Exchange is close to the Romanian entrepreneurial business and SMEs, and offers them easily accessible financing mechanisms, creates the premises for more companies in the IT sector to list on the stock exchange.

The positive context for listings also comes from the macro environment, where the uncertainties of the global climate and the high inflation impose tighter prudential rules for the banks, making the loans a costly financing solution for the SMEs.

If the contextual strategies advanced in this paper are implemented, the authors estimate that the IT companies will better benefit from the opportunities of the Romanian capital market by listing.

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