

Lewandowska, Lucyna

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LUCYNA LEWANDOWSKA*

NewConnect – an alternative platform for new innovative companies**Abstract**

The article discusses the attributes of innovation in the context of creating a knowledge-based economy and presents the alternative stock market NewConnect where the small and medium-sized firms may seek funds to finance their innovative projects. NewConnect's functions and goals are shown with respect to capital circulation, stock market training, education and promotion of SMEs aspiring to enter the Warsaw Stock Exchange in the future, as well as the expansion of the financial infrastructure in Poland and the EU.

1. Introduction

A knowledge-based economy is a challenge for countries and firms all over the world, but particularly in Europe (including Poland) that lags behind the progress of innovation in the USA and Japan. In a knowledge-based economy, **success depends on the creation of new knowledge that, after being materialised, triggers new ideas enhancing value added generated by management processes.** It is so, because strong relationships exist between processes transforming technological knowledge, on one hand, and structures converting outlays into results, on the other, and then between the results and policy (including knowledge policy) with its executive structures (Parwit 2001, p. 128-129). Therefore, a modern approach to knowledge and innovation requires new thinking. Firms have to open themselves up to innovation

* Ph. D., Full Professor at the Univeristy of Łódź

processes. One of the relevant lines of action is the utilisation of research projects carried out by other organizations and then abandoned or uncommercialised for the lack of skills or capital. The owners of such projects may decide to share their research results and this allows incorporating the results into a value-added creation process. Many economists, psychologists and sociologists emphasise the importance of social capital for the creation of innovation⁴⁹. In an open society, a key aspect of knowledge policy is formation of cooperation involving natural persons and firms. A factor that particularly de-emphasises the role of human capital is the existing level of wealth, while social capital, i.e. interpersonal bonds and individuals' ability to cooperate, becomes the key factor in economic development. One of the persons that underline its importance for development is Elinor Ostrom, who was awarded the Nobel Prize in economics in 2009 for her „work on behalf of organizing and improving management in the economy”. Based on her empirical research, she proved that communities managing their own assets are the most effective, make the most relevant decisions and solve arising conflicts the most efficiently.

Innovation is the main engine driving the growth of the world economy today. Firms taking up innovation challenges and realising their innovative projects may hope for steady growth of their worth. Because stimulating and promoting innovation lies in everybody's interest, the Warsaw Stock Exchange (WSE) also decided to promote innovation among the capital market players. The WSE is the first stock market in Europe to develop standards of reporting on intellectual capital for the public companies. The reports will provide a basis for building new products informing the potential investors about innovations in the listed companies from the perspective of their competitive advantages. This approach is expected to promote the WSE as a regional market for innovative companies. The NewConnect platform, a liberal alternative trading market, plays an important role in creating this image. It follows from the opinions expressed by several hundred investors about the broadly understood innovativeness of the NewConnect companies (their way of thinking, the modifications to their environment, the utilisation of new ideas, benchmarking, the degree to which the business model they apply is innovative, goods manufactured and sold, geographical coverage, R+D, investments in infrastructure, the quality of organizational solutions, etc.) that the most innovative companies are Euroimplant SA, Aton – HT SA, Read-Gene SA and Photon Energy a.s. (a Czech firm).

It is worth noting that all NewConnect companies represent industries commonly recognised as innovative (biotechnologies, IT, telecommunications,

⁴⁹ M. in. J. Czapiński, *Polska smuta*, „Polityka” weekly, 2009, no. 16, p. 18.

nanosciences, environmental protection, alternative energy sources, foreign and domestic achievements within science and technology). Much credit should be given here to the tertiary education institutions and the Science and Technology Parks that support companies regarding technology transfers and the application and commercialisation of the results of research on technological innovations. The existing data make it evident that the alternative market NewConnect perfectly matches the SMEs' demand for funds necessary to finance their innovative projects. Owing to their achievements, the NewConnect companies enrich Polish economy and steadily improve the country's competitiveness vis-à-vis other EU countries. Unfortunately, the low capitalisation (below € 10 million) prevents many of them from floating their stock on the regulated market. This barrier is insurmountable for new firms, so NewConnect is their only chance of raising capital. The introduction of identical reporting requirements for both the alternative market and the main market by the WSE Board (quarterly reports) is likely to increase NewConnect's liquidity, as well as boosting interest among the institutional investors. The unceasing evolution and changes taking place on NewConnect aim at better satisfaction of expectations of all players involved in this market.

2. NewConnect as an IPO market for small innovative firms

Ambitious firms always seek strategic solutions, allowing them to generate unique value added, hard for their competitors to copy. The relevant solutions should strengthen their reputation and position in the market that is more and more often viewed in terms of a global market. In many industries, especially those propelling the growth of whole economies (IT, intelligent technologies, nanotechnologies or biotechnologies, the power industry and the pharmaceutical industry), the largest players stopped underestimating the potential of young talented persons working for new, small firms and frequently decide to invest in the development of various ambitious projects that were initiated in small enterprises. The nature of the early growth stages of the NewConnect companies makes their investors accept higher risk, but instead they expect higher than average returns from their investments. Some of the investing entrepreneurs have noticed that by distributing their operations among different continents they can achieve unusual effectiveness, so, for instance, in the USA they deal in marketing, market surveys and customer expectations, but their new projects are developed in Poland. All these activities need capital.

NewConnect enhances the widening range of the available forms and sources of funding.

NewConnect, launched by the WSE on 30 August 2007, provides the growing high-tech firms with opportunities to raise capital. It is an open market with an alternative trading system managed by the WSE SA (Bęben 2008, p. 152). Although NewConnect has the status of an organised market, it functions outside the regulated stock market and its formula is relatively liberal. The investors can be sure of high transparency of trading, characteristic of a public market⁵⁰. The construction of NewConnect is not unique. There are other platforms of this type that have been functioning in Europe for a time, such as AIM in London, First North belonging to the Scandinavian group OMX, Open Market, and Entry Standard affiliated to the Deutsche Boerse. The Warsaw Stock Exchange devised NewConnect for small start-ups with innovative ideas that seek funds for their implementation. By definition, NewConnect is a debut market where the small innovative firms get trained, preparing themselves to enter the WSE.

NewConnect finances small firms with potentially strong growth dynamics, helps them develop high technologies, and allows generating R+D outlays, but it also drives the expansion of financial infrastructure in Poland and particular EU regions. „NewConnect was established for new dynamic firms that can use a capital injection as a chance of exploiting their potential to innovate, and thus as a chance for growth crowned with their promotion to the group of large and valuable enterprises”⁵¹. NewConnect is addressed to new innovative companies that sometimes function in economic niches. The period of less than three years for which NewConnect has been in place coincides with the global financial crisis that has impeded the market’s expansion. Notwithstanding, NewConnect has become very popular. Almost one hundred companies had their debuts there, from which number two have already moved to the WSE.

The NewConnect companies raise capital and sell their stocks via public or private placement. Private placement is more frequent, as its formal and legal requirements are more convenient and the time for reaping the first benefits is relatively short. In private placement, stocks are floated based on the information document⁵² approved by an Authorised Advisor.

⁵⁰ The Act on Public Offering and rules of entering securities into organized trading system and on public companies of 29 July 2005 (Dz.U. no 184) applies to both NewConnect companies and those quoted at the WSE.

⁵¹ WSE SA SA, *NewConnect, rynek akcji GPW, przewodnik dla inwestorów*, Wyd. ART., Warsaw-August 2007.

⁵² The Information Document attached to the Alternative Trading System Rules, <http://www.newconnect.pl>

Before a company can apply for being allowed to join the alternative trading system the issuer's Alternative Advisor has to prepare the information document.

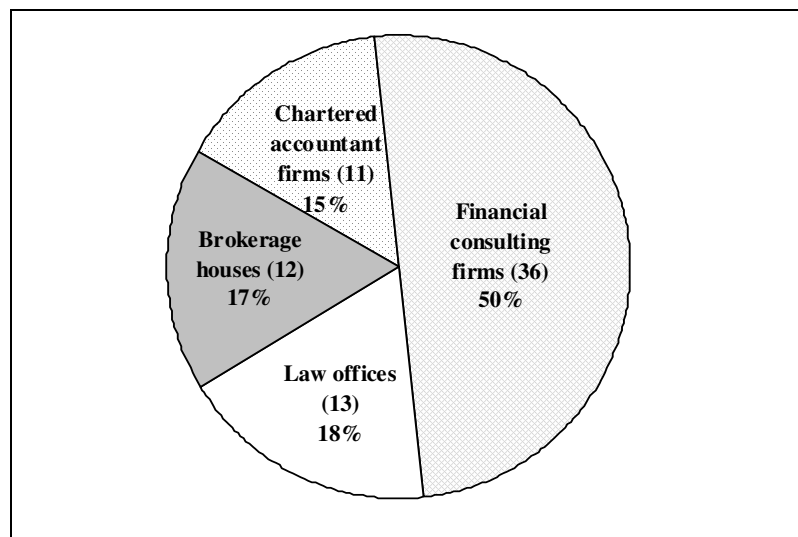
The Authorised Advisor functions in the capacity of the Polish Financial Supervision Authority. The Authorised Advisor must be accepted by the Warsaw Stock Exchange and put on the list of Alternative Advisors.

According to the WSE, the most active Alternative Advisors on NewConnect (by the number of companies they have serviced) are:

- CEE Capital,
- Inwest Consulting,
- Ruciński i Wspólnicy,
- GoAdvisers,
- CapitalOne Advisers,
- ECM Dom Maklerski,
- Kancelaria CSW Więckowska i Partnerzy Radcy Prawni,
- Dom Maklerski,
- Capital Partners,
- Łuczyński i Wspólnicy,
- Beskidzki Dom Maklerski,
- M&M Doradztwo Gospodarcze,
- Bank DnB Nord Polska,
- Chłopecki Sobolewska i Wspólnicy,
- Investin.

Graph 1 illustrates the composition of the group of Alternative Advisors.

Graph 1. Alternative Advisors on NewConnect (% and absolute numbers)



Source: WSE data.

Twenty of the listed advisors are also involved in the WSE Partner Firm Programmes.

NewConnect's experiences prove that the institution of the Alternative Advisor is a perfect response to SMEs' demand for professional advisory services regarding the accumulation of growth capital through the stock market.

The Authorised Advisors must confirm in their declarations that the issuer has provided true information. The contractual relation between these two parties, starting on the day the issuer was accepted by the continuous trading system, is scheduled for at least a year, with the Advisor performing the role of a manager. The Authorised Advisor's responsibilities are detailed in the WSE Board's resolution⁵³.

The entity responsible for ensuring the liquidity of the issuer's stock is a so-called **Market Maker**. Market Maker's involvement goes on for at least two years, from the day the issuer was quoted for the first time. The Market Maker's tasks on NewConnect are precisely defined under the law⁵⁴. Their most important job is ensuring and improving the liquidity of the issuer's stock.

⁵³ Attachment to WSE SA Board's resolution No. 334/2007 of 25 May 2007.

⁵⁴ Attachment to WSE SA Board resolution No. 575/2007 of 6 August 2007.

Investors expect above-average profits and are aware of the risks, but they also want their investees' worth to increase in time. At the early stages of its life, a NewConnect company has to make substantial investments, hoping for large returns. Where can the investment funds come from? This question is faced by the majority of companies developing modern, frequently trailblazing technologies. Banks usually distrust projects that the start-ups found on unproven technologies (these days they are particularly distrustful). In these circumstances, a company may have recourse to EU funds⁵⁵ and/or investors (large firms), venture capital, business angels and finally NewConnect⁵⁶. These types of financial support, especially the assistance offered under the seventh framework programme for research and technological development, inspire special hope among small, ambitious firms. There is a growing number of the IT and biotechnological firms, such as Read-Gene producing genetic tests for tumour-inducing gene mutations, or Euroimplant, a human tissue engineering company. One of the NewConnect companies is Neno that aspires to construct a futuristic car driven by an electric or even hydrogen motor (the company also holds shares in several other innovative Polish firms) (Grzeszczak 2007, p. 40). NewConnect, being part of the capital market, allows its issuers to raise capital, while enabling the investors to profit from property and corporate rights. As a result, the market and its environment expand dynamically. „From this point of view, NewConnect may also be treated as a sort of a community, because the WSE started a community portal NewConnect all the People that associates investors, entrepreneurs, advisors, market makers, stock exchange representatives and all persons interested in NewConnect” (Duraj 2008, p. 105).

Firms planning to enter NewConnect must have the prescribed organisational and legal forms (a joint-stock company or a limited joint-stock partnership), as well as presenting the aforementioned information document. Besides, they cannot be involved in insolvency or winding up proceedings and their financial expectations cannot be excessive (within ca. 20 million zlotys). The dynamics of trading during the successive sessions depends on two major factors:

⁵⁵ In 2009, the EU's allocations earmarked for Poland under the National Operational Programmes (€ 10,147 bn) were consumed in 23% by 3 May 2009 and regarding the Regional Operational Programmes (€ 6.571 bn) it was only 6%, with the Łódź voivodeship accounting for less than 2% (the Ministry of Regional Development data). Instead of being an anti-crisis shield, the funds are wasted.

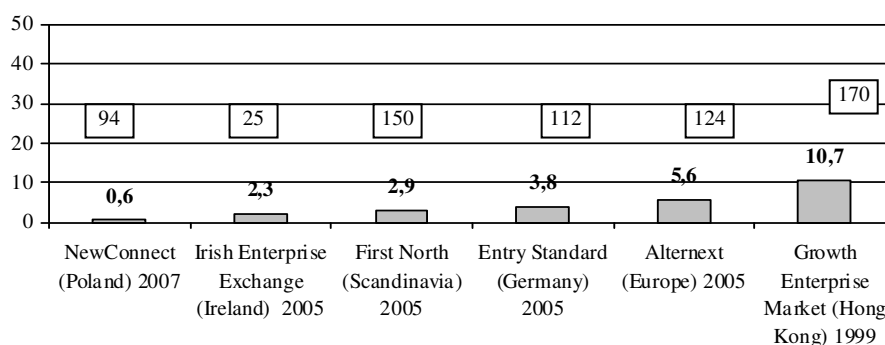
⁵⁶ More in L. Lewandowska, *Kapitałowe uwarunkowania rozwoju wysokich technologii w MSP* [in:] S. Lachiewicz, A. Zakrzewska-Bielawska (ed.), *Zarządzanie...*, op. cit., p. 44-53.

- the present market situation, and
- new issues on NewConnect.

NewConnect's trading capacity increased in December 2008, when the package deals were allowed (in the same month the deals were estimated at more than 14.1 million zlotys). Naturally, the largest companies (Pharmena, Quercus, Photon, PTI) contribute to NewConnect capitalisation the most distinctly. In total, the first ten companies account for 38% of the NewConnect issuers' market value.

Evaluated against similar markets in the world, the Polish stock market for the promising innovative firms is viewed as attractive. However, any comparisons are rather superficial, as the alternative markets do not have much in common but their name. It is unquestionable, though, that they offer more liberal environment to the small and medium-sized firms than the main markets do. In the time of crisis, their indexes do not show stronger fluctuations than those noted for the main markets. Graph 2 compares NewConnect with the smaller alternative markets.

Graph 2. Comparison of selected, smaller alternative markets. Market capitalisation (\$ bn)



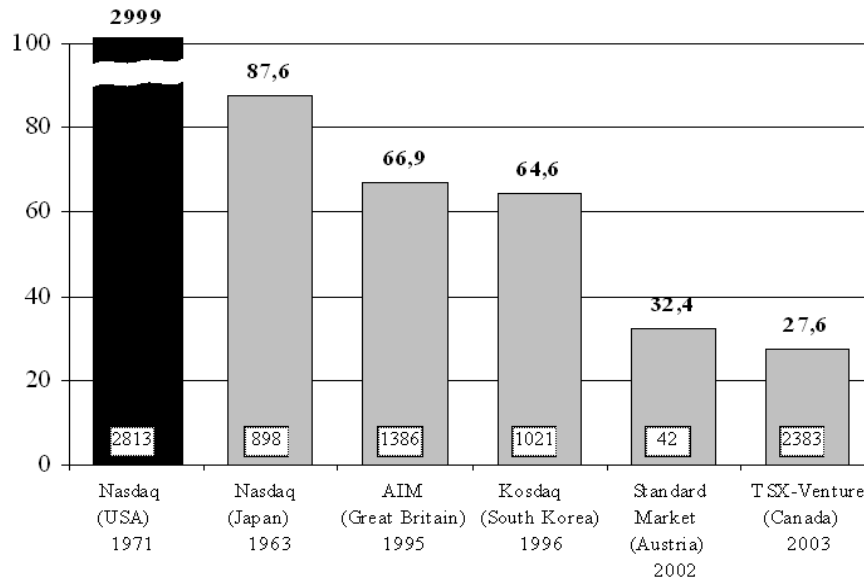
94 - the number of quoted companies
 2007 - the year the market was established
 0.6 - capitalisation as of July/August 2009

Source: *Giełdy*, Bloomberg; after G. Siemiończyk, *Rynki alternatywne podobne tylko z nazwy*, [in:] *Almanach rynku alternatywnego*, WSE – 2009, p. 7.

The capitalisation of the largest alternative markets is much larger. Some of them, for instance AIM in the UK, are even able to attract companies from the main markets. Owing to the tax relieves offered to investors, AIM managed to draw 31 firms from the main market in 2006 alone, while only 3 organisations

moved the other way. Graph 3 illustrates capitalisation levels on the aforementioned markets.

Graph 3. The largest alternative markets by capitalisation (\$ bn)



Source: For the legend and source see Graph 2.

3. NewConnect and free movement of capital in the EU

The homogenisation of financial markets in the EU is a natural response to globalisation.

Innovation, already discussed in the earlier part of the article, has a positive effect also on the global flows of capital. Owing to IT infrastructure, innovation allows increasing the variety of financial products and reaching a larger number of clients all over the world.

The range of measures intended to facilitate free movement of capital within the EU includes a list of projects to be carried out in the period 2005-2010 that was compiled and then published in the „White Paper”⁵⁷. The projects

⁵⁷ <http://www.pwc.com>, January 2007

are hoped to encourage investment activities, particularly those involving innovative projects, and to stimulate the expansion of capital markets, including the WSE and NewConnect.

The European Union focuses on:

- integrating open, competitive financial markets,
- minimising barriers obstructing capital flows,
- harmonising legislations,
- ensuring the convergence of financial supervision,
- tightening cooperation with the global financial markets,
- increasing its share in the global market.

Fulfilling the above goals will certainly contribute to better mobilisation of capital. The WSE and NewConnect have assumed the same goals. They are even more important for NewConnect, because a larger number of investors is likely to provide its companies with better access to capital⁵⁸ translating into the implementation of innovations and the reinforcement of the companies will boost the growth dynamics of the country's economy. The empirical evidence⁵⁹ provided by the growth pattern of many NewConnect companies shows that the stock market created for the ambitious, small, innovative companies to raise capital works well and bridges the financing gap, as it provides the high-tech SMEs with a supportive financial and institutional environment they need to grow. The most recent recommendation by the Small Business Act provides for the rules of creating this type of policy by all EU governments.

Trying to assess the start-ups' market indicators (such companies predominate on NewConnect) we need to remember that because of the relatively low profits such companies have in the early years of their functioning all of them have to be allocated to innovation, which results in a high price-earnings ratio and the retention of dividends.

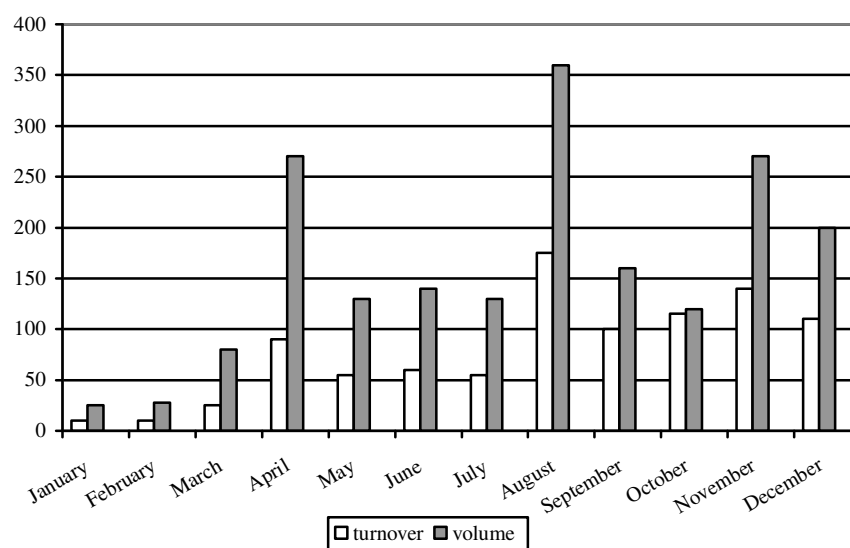
The year 2009 can be deemed a good year for the alternative stock market in Poland. In January 2009, its indices started from the level of 38.22 pts and reached their highest annual value, 49.82 pts, on 7 December; the annual index was 49.7 pts. The whole market grew by 30.04%.

⁵⁸ Limited access to capital is reported by every fifth small enterprise in the EU (see Observatory of European SMEs. Analytical Report. Flash Eurobarometer No. 196). The Gallup Organization, May 2007, p. 16.

⁵⁹ A detailed description of Milkpol SA debut and growth on NewConnect can be found in L. Lewandowska, *NewConnect jako źródło kapitału dla obiecujących innowacyjnych firm* [in:] L. Lewandowska (ed.) *Formy wspierania przedsiębiorczości w regionie łódzkim w warunkach kryzysu gospodarczego*, PTE, Łódź 2009, p. 331-347.

Monthly turnover and volume by month of the analysed year are presented on Graph 4.

Graph. 4. Turnover and volume for the NewConnect companies in 2009



Source: IPO.pl based on www.gpwinfostefa.pl and www.stooq.com after W.Dembski, Ipo.pl, www.ncbiuletyn.pl

The graph omits companies that split their stock or effected rights issues in 2009. In addition to those NewConnect companies that showed growth (58), there were also companies whose worth decreased and one firm whose stock value did not change.

In 2009, 26 firms entered NewConnect (there were 61 IPOs in 2008), increasing the total number of its listed companies to 107 by the end of the year. Because the NCIndex was calculated for 10% of the largest companies, the whole market showed a 30% growth vis-à-vis 2008. Its total capitalisation was 2554m zlotys in 2009, exceeding its 2008 level by 83%.

Despite this strong growth, NewConnect liquidity continues to be relatively low. A daily turnover for all the companies is 4.6m zlotys.

The above shows that NewConnect is a marketplace where investors can earn a lot but also suffer heavy losses. Therefore, considering that the obligatory financial reports of the listed companies have a limited scope, the potential investors should take into consideration other firms' characteristics, such as the

types of innovation, human capital, projected events, issues discussed at the general meetings, etc.

Attempting to improve the operational transparency of the NewConnect firms, the WSE runs surveys to determine how innovative they are, for the time being only among the investors-members of the aforementioned community NewConnect All The People.

To promote good practices, the WSE Board's resolution no 795/2000 of 31 October 2008 made it obligatory for the listed companies to adhere from 1 January 2009 to the rules laid down in the document „Good Practices Of Companies Listed on NewConnect”. According to the resolution, the NewConnect issuers have to publish annual reports with the descriptions of the applied corporate governance rules starting with the 2009 report.

4. Conclusion

NewConnect has become a platform that provides the small and medium-sized companies capable of developing innovations with financial, educational, methodological and promotional opportunities.

Therefore, NewConnect helps change and improve Polish economy via the generation of GDP, new jobs, stimulation of export activities, and by increasing the worth of small companies that want to become strong public companies one day.

Supplementing the range of financing options such as investment loans, EU funds, mezzanine finance, venture capital, and business angels with an environment where companies can seek funds to develop high technologies, NewConnect becomes part of the plan for expanding the financial infrastructure in Poland and the EU.

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Streszczenie

NEWCONNECT – ALTERNATYWNA PLATFORMA DLA MŁODYCH NOWATORSKICH SPÓŁEK

W artykule zaprezentowano atrybuty innowacyjności w kontekście kreacji Gospodarki Opartej na Wiedzy oraz alternatywny parkiet NewConnect, stanowiący szanse pozyskiwania kapitału na nowatorskie projekty przez małe i średnie firmy. Wskazano na realizowane funkcje i zadania NewConnect w dziele przepływu kapitału, treningu giełdowego, edukacji i promocji małych i średnich spółek aspirujących w przyszłości do zajęcia pozycji na GPW oraz rozbudowy infrastruktury finansowej Polski i Unii Europejskiej.