

**Does One Size Fit All? The Consequences of Switching Markets  
with Different Regulatory Standards<sup>†</sup>**

Tim Jenkinson

*Saïd Business School, University of Oxford and CEPR*

Tarun Ramadorai

*Saïd Business School, University of Oxford, Oxford-Man Institute and CEPR*

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**Abstract**

As the regulation of public companies has progressively tightened in recent years, many companies have chosen to switch to stock exchanges with lower regulatory requirements. We analyse the consequences of switching for smaller quoted companies, using the unusual regulatory environment in London, which has two markets with different regulatory regimes but the same trading technology. Firms that switch to lighter regulation experience negative announcement returns of approximately 4%. However these initial price reactions are reversed after the actual switch. We also find an intriguing longer-term upward drift in stock returns, which we relate to improved operating performance.

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It is often taken as axiomatic that investors prefer higher levels of regulation of public companies, and in recent years, often following scandals or crises, many countries have progressively increased the level of such regulation. The most notable example of this tendency is the passing of the Sarbanes-Oxley Act in the U.S., but world-wide, stock exchanges have been increasing and tightening their requirements of listed companies in diverse areas, including firms' compliance with codes of corporate governance and the information that listed firms must include in their prospectuses.

At the same time, we see many companies fleeing high regulatory burdens. Recently, there has been a collapse of international listings in the U.S. following the introduction of Sarbanes-Oxley, and some U.S. companies have chosen to float on non-U.S. exchanges. A particularly impressive recent development is the enormous growth of the lightly-regulated Alternative Investment Market (AIM) segment in London, which attracted close to 1000 new (relatively small) companies during 2005-2006, and now includes 60 U.S. companies. The recent success of AIM has resulted in other stock exchanges launching similar segments, such as the Alternext market recently launched by NYSE-Euronext, and First North, part of the NASDAQ-OMX group of exchanges, which covers the Nordic and Baltic regions.

AIM's success has also attracted negative attention, prompting calls from the leaders of rival exchanges and regulatory authorities for AIM to raise its regulatory requirements.<sup>1</sup> This leads us to the question we address in this paper: what are the consequences for companies, and their investors, of switching between markets with different regulatory standards?

Financial markets are largely defined by regulation and technology. Regulation includes financial services regulation, company law, and the specific requirements imposed by the markets themselves. Technology relates to the trading systems that allow market participants to interact with each other and to establish prices at which to trade. Comparisons between markets are generally difficult as both technology and regulation differ significantly. However, in this paper we consider the impact of regulation in a very

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<sup>1</sup> See, for instance, the article in the Financial Times, 27 January, "NYSE chief says AIM must raise standards", which reports that NYSE chief executive John Thain suggested that "London's Alternative Investment Market lacks stringent corporate governance requirements for listed companies and should keep raising its standards." Furthermore, on March 9, again in the Financial Times, SEC commissioner Roel Campos is quoted as saying that AIM "...feels like a casino to me, and I believe investors will treat it as such".

direct way, by analysing the experience of companies that switched between markets which differ primarily in their levels of regulation.

The two markets that we consider are both part of the London Stock Exchange (LSE). The Main Market (MM) of the LSE comprises *listed* securities.<sup>2</sup> The MM (also referred to as the “Official List”) comprises companies that have both satisfied the requirements of the UKLA and continue to abide by the additional rules imposed by the LSE. However, the shares of a company can also be traded on the AIM market segment of the LSE *without* it being a listed security. As we explain in the next section, the regulatory environment for AIM involves a high degree of self-regulation by the company’s nominated advisor, which acts as the main quality control mechanism. Companies on AIM also face fewer continuing obligations in terms of reporting and corporate governance. However, the trading mechanisms used by AIM companies are identical to those used by listed companies on the MM, and both markets are subject to the same UK legal system that protects the rights of shareholders.

Many countries have second-tier markets, but a number of features of the UK markets make them particularly suitable for our purposes. First, both markets are well-established and have large numbers of companies trading on them: at the end of 2006, there were around 800 companies<sup>3</sup> on the MM, and just over 1600 on AIM. Of prime importance for our research, there has also been a significant flow of companies switching *between* the markets. Perhaps surprisingly, the net flow of companies switching markets has been very heavily towards AIM. Our sample comprises 218 companies that have switched “down” to AIM, and 56 companies that switched from AIM “up” to the Main Market.

Second, as noted above, the growth and popularity of AIM has been phenomenal in recent years. Although still predominantly a market that attracts smaller companies, over a quarter of AIM companies have market valuations above £50m (\$100m). AIM has attracted a growing number of overseas companies onto its market: nearly 400 foreign companies were quoted on AIM at the end of 2006. In contrast to the

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<sup>2</sup> The term “listed” is often used to refer to any company quoted on a stock exchange. However, in this paper we focus on the distinction between the regulatory environments of the two London markets, and so we reserve the use of this term for companies that have satisfied the formal listing requirements of the UK Listing Authority (UKLA), which is a part of the Financial Services Authority (FSA).

<sup>3</sup> The headline figure for the number of Main Market companies is considerably higher: there were 1276 entities traded at the end of 2006. But if financial vehicles, such as investment trusts, and duplicate securities, such as preference or convertible shares, are excluded, the number of distinct trading companies falls to around 783.

500 new companies joining AIM per year during 2005 and 2006, the MM attracted, on average, only 19 IPOs per year during this period.<sup>4</sup> Consequently, our research has the additional benefit of shedding light on the factors that have made AIM so attractive to companies, both domestic and foreign.

Third, unlike some other markets where the exchange can “de-list” a company for failing to comply with one or more of its standards, the LSE has few ongoing standards (e.g., minimum market capitalisation requirements) that result in companies being obliged to move down to AIM. The main exception is the requirement that at least 25% of the share capital of a firm should be in public hands. Except for five of the companies that moved to AIM, the switch was a deliberate choice by the firm, rather than a condition imposed upon them by the LSE. Furthermore, the decision to switch markets was at the discretion of the management, and did not require shareholder approval. While there may be agency issues involved, it would be surprising if the widespread switching that we observe were anticipated to harm shareholder interests.<sup>5</sup>

Finally, trading and accounting information on switching firms is readily available in London’s markets. Liquidity does not differ much as companies switch between AIM and the MM, which stands in contrast to the U.S., where moving off the major exchanges often leads to a collapse in trading activity. Furthermore, while U.S. companies often “go dark” (stop reporting accounting information) following SEC deregistration, there is no such issue in the U.K., as all companies are required to publish this information regardless of whether they are subject to UKLA regulation or, for that matter, traded on a stock exchange. This enables us to analyse the immediate impact of switching markets and regulatory standards on share prices as well as on longer-term firm operating performance.

To summarize our main results, we find large and significant announcement effects associated with the decision to switch market segments. Companies moving from AIM to the MM experience significant announcement effects, on average, of around +6%. Thereafter, performance is broadly neutral,

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<sup>4</sup> This figure excludes financial entities (classified by the LSE as equity investment instruments, investment companies, investment entities and real estate).

<sup>5</sup> As an example – albeit more strongly expressed than most – of the reasons given for switching to AIM, the Chairman and Chief Executive of Arbuthnot Banking Group explained to the Financial Times why the company, having been listed on the MM for 17 years, was switching to AIM: “AIM ... offers a lighter regulatory touch ... it will provide some relief from the regulatory onslaught that is costing us £1.25m a year – a lot for a company whose profits last year were £5.5m.” (Financial Times, July 14, 2005).

although some forms of risk-adjustment generate mildly negative returns. Companies switching from the MM to AIM experience announcement effects averaging around -4%. However, this is not the end of the story. Once these companies actually start trading on AIM, average returns are strongly positive, with cumulative abnormal returns standing at approximately +20% six months following the switch. The net result viewed over this longer event window is, therefore, strongly positive.

We investigate various possible explanations for this pattern of returns, including whether operating performance changed post-switch. We find significant improvements in performance in the two years following the switch to the less regulated AIM environment, which is consistent with the general pattern of shareholder returns. Our results suggest that the most suitable regulatory regime may differ across companies, and that the management of the smaller quoted companies that switched to AIM were not, in general, acting against the interests of their shareholders.

The results in this paper relate closely to prior work in a number of different areas. There is a well-established literature examining the various costs and benefits associated with regulation, in particular financial reporting and disclosure rules (for an interesting survey of this literature see Leuz and Wysocki (2008)). Changes in regulatory rules have often been the focus of such research, for instance the impact of the U.S. Securities Act of 1933 and the Exchange Act of 1934 (Stigler (1964), Benston (1973), Simon (1989), Mahoney and Mei (2006)), the 1964 Securities Acts Amendments (Ferrell (2004), Greenstone, Oyer and Vissing-Jorgenson (2006)) and the more recent adoption of Regulation Fair Disclosure in 2000, and the 2002 Sarbanes-Oxley Act (Coates (2007), Leuz (2007)). While different authors arrive at different conclusions, in general this literature suggests that policymakers' enthusiasm for tighter regulatory standards is not matched by unambiguous evidence that the benefits outweigh the costs. Furthermore, some authors have recently cautioned that the optimal amount of disclosure and reporting is likely to vary across firms (see, for instance, Bushee and Leuz (2005), Iliev (2007)), while others (Duarte, Kong, Young and Siegel (2008)) argue that there was no differential response for small and large firms to the introduction of Sarbanes-Oxley. Our paper contributes directly to this debate, and suggests that one-size-fits-all regulation could impose significant costs on small firms.

In addition to the literature on the impact of regulation, a few previous studies have analysed the consequences of switching markets for firm performance. For instance, Angel *et. al.* (2004) focus on those companies that were forced to de-list from Nasdaq and ended up being traded on the Pink Sheets. They found that “trading down” to the Pink Sheets cost shareholders dearly. However, the Pink Sheets are essentially a quotation service where only broker-dealers can apply to make a market in the securities, rather than a stock exchange.<sup>6</sup> In contrast, although lightly regulated, AIM is a market segment of one of the world’s leading stock exchanges, and shares common trading technology with the Main Market.<sup>7</sup> Furthermore, the companies we study *chose* to switch market segments, rather than being forced to switch as a result of either violating existing rules or the imposition of more stringent rules.

A closely related literature considers the impact of listing companies on foreign stock markets. The main motivations for these cross-listings that have been suggested in the academic literature include increased liquidity, and a variety of potential corporate governance benefits associated with ‘bonding’ to more stringent legal, regulatory or disclosure rules, with a view to overcoming potential agency conflicts (Stulz (1999)). Such cross-listings have close similarities to moving from a less-regulated market, such as AIM, to a more regulated market, such as the MM. In recent years a number of papers have pointed to the potential drawbacks of cross-listing, including information asymmetry problems and increased cost of compliance with foreign corporate governance and legal systems (see Karolyi (2006) for an excellent survey). The context for this somewhat more sceptical view of the costs and benefits of cross-listings has been the dramatic decline in the number of cross-listed companies. For instance, Karolyi (2006) reports that between 1997 and 2002 the global number of cross-listed stocks fell by more than 50%. The reduction of cross-listings, and IPOs of foreign companies, has been particularly noticeable in the U.S. since the

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<sup>6</sup> It should be noted that the quotation services offered by the Pink Sheets and the Nasdaq Over-the-Counter Bulletin Board (OTCBB) in the U.S. differ from AIM in some important respects. As noted by Macey and O’Hara (2004), the Pink Sheets and OTCBB do not provide issuer listing services but rather provide a quotation service to market makers. In regulatory terminology, Pink Sheets is considered a “non-exclusive securities information processor and inter-dealer quotation system”, and is neither an SEC registered exchange nor an NASD regulated broker/dealer (source: [www.pinksheets.com](http://www.pinksheets.com)), and the OTCBB is a “regulated quotation service” for equity securities that are not listed or traded on Nasdaq, NYSE, or any other national securities exchange. In contrast, AIM is a market run by the London Stock Exchange, upon which companies can conduct IPOs, can be included in benchmark indices and can be traded using the trading technology provided by the LSE.

<sup>7</sup> Changes to trading technology have been shown to have significant impacts on stock prices. See Jain (2005) and Easley, Hendershott and Ramadorai (2008) for two recent examples.

passing of Sarbanes-Oxley, and has sparked an interesting debate about whether New York is losing competitiveness to London (see, for instance, Doidge, Karolyi and Stulz (2007), Zingales (2006)). AIM has bucked this general trend and has been attracting overseas listings in increasing numbers, although the small average size of such companies means that many were not realistic candidates for a US cross-listing.

Our research design enables us to consider such issues from a rather different angle. Rather than compare the relative benefits of listing across countries, where the differences in legal system, taxation, regulation etc. are often complex, and where it is necessary to control for firm characteristics (such as size, industry, etc.), we focus on switches by a *given* company between market segments within a *single* country. It is unambiguous that the MM is more highly regulated than AIM. The legal and trading systems are the same. The only complexity arises from the need to investigate the potential impact of the tax consequences of switching market segments, although we find no significant impact arising from taxation. Thus, although our focus is exclusively on companies trading on the London markets, our analysis has broader relevance to the cross-listing debate, and the general policy concern about the impact of regulation, broadly construed, on the competitiveness of markets.

The remainder of the paper proceeds as follows. In the next section we describe the regulatory environment existing in London, and explain how this is well-suited as a test-bed for our research. In Section II we provide summary information on the development of the two market segments, which shows the impressive growth of AIM, both in terms of companies switching from the MM as well as IPOs. We also describe how our sample was constructed, and give some descriptive statistics on the switching companies. The typical company that switches market is smaller than average, although is long-established. Therefore, our analysis is more relevant to smaller quoted companies, for which the costs and benefits of regulation may be finely balanced. Section III contains our econometric analysis of the impact of switching on company valuation and share turnover. Section IV concludes.

## I. Alternative Regulatory Regimes

The Main Market and AIM are the two most important markets run by the London Stock Exchange (LSE). Until 2000 the LSE regulated the formal listing requirements for companies, at which point this regulatory function was transferred to the UK Listing Authority (UKLA), itself part of the UK Financial Services Authority (FSA). The Main Market (MM) of the LSE is a *regulated market* as defined by the EU Investment Services Directive whereas AIM is designated as an *exchange regulated market*. In practice this means that companies seeking admission to the MM have to obtain prior approval by the UKLA – whose rules have to be consistent with EU legislation<sup>8</sup> – as well as satisfy the requirements of the LSE. In contrast, the rules for admission to AIM are entirely determined by the LSE, and the main principle that has been adopted is that companies seeking admission should engage, and obtain the approval of, a nominated advisor (or “Nomad”), who will guide them through the process and certify that they are appropriate companies to be traded on AIM. Nomads tend to be smaller investment banks or corporate finance advisory boutiques; to date the bulge-bracket investment banks have not entered this market.

A summary of the current admissions criteria and continuing obligations for the two markets is presented in the Appendix in Table A1. The table shows that the MM has admissions criteria that are commonly observed at leading stock exchanges, such the requirement to have an established trading record, minimum market capitalisation and free float rules.<sup>9</sup> The main difference between the two markets is that the MM involves considerably higher levels of compliance, and greater on-going obligations regarding disclosure and transparency. The rules are extremely detailed and prescriptive, and include requirements on the timing, content and frequency of financial reports; the need to publish six-monthly management statements; mandatory compliance with the Takeover Code; the requirement to comply, or explain in a public statement, the extent of any non-compliance with the Combined Code on Corporate

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<sup>8</sup> European regulation is converging such that all EU stock exchanges will admit companies to their regulated markets if they have satisfied *any* recognised EU competent authority for listing.

<sup>9</sup> To quote the LSE, “A primary listing means the company is expected to meet the UK’s gold standard – described as super-equivalent to the EU directives and implemented as part of the Financial Services Action Plan - and as a consequence may enjoy a lower cost of capital through greater investor involvement.”

Governance; a requirement to notify and/or obtain prior shareholder approval for many types of transactions, including share option plans, secondary issues, and the acquisition or disposal of fixed assets; requirements to issue circulars to shareholders; rules relating to the content of such circulars, and the need to obtain prior approval of the FSA; and a requirement for all management and any employees with access to inside information to comply with the wide-ranging Model Code relating to share dealing. This just gives a flavour of the continuing obligations associated with being on the MM, the full details are contained in the FSA Handbook, in particular the chapters relating to *Listing Rules* and the *Disclosure and Transparency Rules*. We investigated switching firms' published reasons for their choice to switch to AIM, and the most commonly cited reason was the burden imposed by the continuing obligations associated with the MM's listing rules.<sup>10</sup>

The rules at the LSE MM are very similar to those that apply at most of the major stock exchanges around the world, albeit with differences in detail, emphasis and legal status. Collectively, these are what we refer to as *regulation*. For our purposes, the details of these various aspects of regulation are not important; what matters is the contrast with the regulation of firms quoted on AIM.

This contrast is striking. In terms of the rules regarding admission to the market, it is literally possible to create a new company and have it trading on the AIM market within two to three weeks, provided a Nomad can be found to support the application. The only rules regarding timing are (1) that a company seeking admission to AIM should provide the LSE with basic descriptive information about the company at least 10 business days before the expected date of admission (the "rule 2 announcement"), and (2) that at least 3 business days before admission, an applicant must submit an admission document, a completed application form, and the relevant fee (the "rule 5 application"). Note, in particular, that there are no rules regarding the minimum number of shareholders, unlike, for example, the New York Stock Exchange and NASDAQ. These institutions require a minimum of 2,000 and 400 investors<sup>11</sup> at the time of IPO respectively.

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<sup>10</sup> The LSE has a few additional obligations that relate to MM (but not AIM) companies, but these are relatively trivial, relating, for instance, to the need to agree with the exchange about timetables for announcements, dividend declarations, and open offers for shares.

<sup>11</sup> The regulations are formally stated in terms of "round-lot holders" of at least 100 shares.

AIM companies also have far fewer continuing obligations than their MM counterparts. Most of the regulations mentioned above for MM companies do not apply to AIM companies. The main requirements for AIM companies derive from general company law and securities regulations (including certain aspects of EU legislation, such as the prospectus directive) which apply to all public (but not necessarily listed) companies. Furthermore, much of the regulatory burden of AIM companies is devolved to their Nomads. For example, Nomads must certify that an AIM company is fit to be traded on public markets, and that its management understand their obligations. Until early 2007, no rule book existed for Nomads, who were guided only by very general principles. The first rulebook has recently been published.<sup>12</sup> However, this codification of the requirements for Nomads confirms the continued relative lack of regulation of AIM companies, beyond some basic rules regarding providing information to investors in a timely fashion, and abiding by securities regulations regarding insider trading. This lack of formal regulation lies behind the somewhat tendentious comments about AIM noted in the introduction.

During the sample period that we consider (the period from the inception of AIM until the end of 2006) the decision to switch between the MM and AIM could be made by management. This was true both for switches from the MM to AIM (where, perhaps surprisingly, such decisions were not a matter upon which the listing rules required shareholder approval) and for companies switching from AIM to the MM. Of course, for the latter group, the approval of the UK Listing Authority was required. In 2007, the rules were changed so that firms switching from the MM to AIM need to obtain the approval of a majority of the shareholders before doing so.

Why do companies choose to switch market segments, especially those that are choosing to move to AIM? A typical statement (from Bradstock Group plc) emphasizes the regulatory environment on the MM as a reason to move to AIM:

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<sup>12</sup> See the *AIM Rules for Nominated Advisors*, February 2007, available from the LSE website.

“We continue in our endeavours to identify new activities that will enable the Group to develop its business. We are, however, currently restricted in the transactions that we can undertake due to the high costs that would need to be incurred to meet the stringent UKLA rules. We have concluded, therefore, that it would be in the best interests of the Company for it to transfer its listing to the AIM. The AIM rules are less prescriptive than the UKLA’s rules and we believe that it is appropriate for the Company to move to AIM to enable it to take advantage of the greater flexibility afforded by that market.”

Other reasons given by a number of firms emphasize the positive benefits of the AIM market. For instance, Abbey plc (a housebuilding company operating in the UK and Ireland, incorporated in Ireland, and previously on the Official Lists of the London Stock Exchange and the Irish Stock Exchange) transferred to AIM in November 2004 and stated:

“AIM is a fast growing market focussed on growing companies. AIM companies enjoy wide investor support. AIM is gradually attracting an increasing number of international companies and is, the Board believes, well placed to become the European market of choice for successful growth companies. All AIM companies, irrespective of their origin, are included in the FTSE AIM index, in direct contrast to the UK FTSE Indices for the UKLA Official List companies which generally exclude non UK registered companies. The inclusion of Abbey in the AIM index should of itself encourage significant additional interest in the Company. The UK authorities continue to support the development and growth of the market, in particular by maintaining a significantly more attractive fiscal regime for UK investors in AIM companies than is accorded to investors in UKLA Official List companies. Overall the regulatory regime attaching to AIM companies is better matched to their circumstances as small successful growing companies than that attaching to the larger companies on the UKLA Official List.” [RNS announcement, 15/10/04].”

This statement is interesting in drawing attention to the possible increased investor interest that might result from being traded on AIM. In part this might result from inclusion in stock market indices, as noted in the above quotation. Consequently, we investigate whether such index-inclusion effects are important in our study. We also investigate whether changes in shareholder composition are observed when companies switch markets. Mention is also made in the above quotation of certain tax differences that exist for companies on AIM relative to the MM. Although the main differences between being on the MM or AIM relate to what we term governance issues, at various times in our sample period there have been some differences in the way in certain investors are taxed, according to whether or not the share were “listed”. We provide more detail about the tax issues in the Appendix, and conduct robustness checks to show that our results are not affected by changes in the tax regime.

In the next section we describe how the sample was constructed, and present descriptive statistics of the data.

## II. The sample and descriptive statistics

The Main Market in London is long-established, with roots that can be traced back to the 17<sup>th</sup> century. While AIM is a much more recent phenomenon (launched in June 1995), the concept behind it is not new: the LSE previously created a market segment for smaller companies, called the Unlisted Securities Market (USM), which was only modestly successful. When AIM was launched, companies that were on the USM were given the option of switching onto AIM, which many of them took.<sup>13</sup>

The growth of AIM can be seen in Appendix Table A2, which shows the number of new admissions (including IPOs and switches from the MM), the number of overseas companies joining AIM and the trends in terms of money raised. As can be seen, the number of companies on AIM grew steadily until 1999, at which point the growth accelerated. From 347 companies trading on the market in 1999, the number at the end of 2006 stood at 1634. Of course, the market valuation of the MM companies still swamps that of AIM, which attracts mainly small, growing companies. But there has been an increase in the economic significance of AIM as a source of capital, with nearly £16 billion being raised by AIM companies in 2006. Furthermore, the growth of international companies choosing AIM has been very impressive, especially since 2004 – 305 new overseas companies have joined the market between 2004 and 2006.

To construct our sample of companies that switched from the Main Market to AIM and vice versa, we use data from the LSE, which classifies all AIM admissions, and has done so from the time of the inception of AIM. Between June 1995 and the end of 2006, 267 companies switched down to AIM and 73 switched up from AIM to the MM. Of the down switchers, we excluded one investment trust, and five companies whose primary listing was not in London. We then searched on Datastream for information on

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<sup>13</sup> This can be seen from Table A2, where the 123 new admissions to AIM in 1995 raised only £70m. This is because most of the companies who joined AIM in 1995 were switching from the USM, rather than conducting an IPO.

the remaining companies and could find data for all except five. This resulted in a base sample of 256 companies that moved down to AIM.

While the date of the actual switch is recorded in the LSE database, typically, the management of the firm announces the intention to switch a few weeks prior to the switch. To find this announcement date for each company, we searched for up to a year prior to the switch date on Factiva, a database which encompasses newspapers, newswires, and the Regulatory News Service (RNS) provided by the London Stock Exchange. As noted earlier, during our sample period managers were not required to seek approval from shareholders to switch market segments. For down switchers, provided the company has the support of its nominated advisor, AIM admission is assured. For switching up to the MM, the approval of the UKLA is required, although normally the company would not announce a switch without first having checked that they satisfied the UKLA requirements. Consequently, although the typical announcement is expressed in terms of a future *intention* to switch market segments (such as “the company intends to transfer its listing to AIM” or “the company will be seeking admission to AIM” or “the board has resolved to transfer to the Main Market”), in effect these are more or less equivalent to announcing a firm decision to switch markets. As a potentially price-sensitive decision, the switching announcement should occur on the RNS first and this is indeed what we find. This results in a very precise definition of the announcement event, with very few cases of prior leakage of news.<sup>14</sup>

The news searches were also used to check whether any concurrent news or events occurred at the same time as the decision to switch to AIM was first announced. These concurrent announcements fall into four main categories (a) the announcement of financial or trading results, (b) share issues or capital restructurings, (c) acquisitions and disposals, and (d) violations of one or more of the listing rules. This final category of concurrent announcements is very infrequently observed. For these firms, the decision to switch to AIM was essentially forced onto the company as a result of a prior or anticipated violation of the listing rules (typically the violation related to the requirement for 25% of the company’s shares to be in

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<sup>14</sup> There are two companies where the announcement was made at a shareholder meeting and was subsequently reported to the RNS the next day and four days later, respectively. We use the earlier announcement date in both cases.

public hands). We leave such companies in the sample but control for the possibility that the potentially involuntary nature of the switch to AIM communicated some information to the market.<sup>15</sup>

The most frequently observed concurrent announcements relate to updates on trading or financial performance. In most cases these were routine updates, rather than announcements of major deteriorations or improvements in performance.<sup>16</sup> The other two categories of concurrent announcements (share issues and capital restructurings; acquisitions and disposals) are rather more varied within the sample. In many cases, these transactions were rather minor in nature: for instance, the announcement of the disposal of a relatively small asset or business, or the issuance of new equity in relation to a new stock option plan. In these cases, we leave the firms in the sample, and control for the possibility that new information could have been provided to the market by these transactions.<sup>17</sup>

However, in some more complex cases, announcements are highly significant to the company's valuation, and likely to swamp any effect of the switch. For instance, in some cases there was an announcement of a major acquisition or disposal that would transform the overall composition of the company. We are concerned to isolate, as far as possible, the impact of the switch to AIM, and in the case of such major concurrent transactions this will clearly be impossible. In general, we employ the filter that if transactions require shareholder approval, they are excluded from the sample. Furthermore, in some cases the announcement of the switch to AIM occurred when a major transaction was in process. In such cases, the shares were suspended at the time of the first announcement, and we exclude these firms from our sample as well. Collectively, these filters have the effect of excluding a variety of companies who announced their switch to AIM at the same time as (or during) major transactions such as reverse takeovers, significant changes in corporate control (including takeovers, or issuance of options that, if exercised, would gain control), the sale of a main businesses, or where a company was, or became, a cash

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<sup>15</sup> We say *potentially* involuntary as there appear to at least one case where the violation of the rule – via the exercise of an option by a large shareholder/executive – was a deliberate strategy to require the company to move from the Main Market, possibly against the will of the other executives.

<sup>16</sup> Our results are robust to excluding all firms in the sample which made these announcements concurrently with the announcement to switch market segments.

<sup>17</sup> Our results are qualitatively unaffected when we drop these firms from the sample, as we show later.

shell. There are 38 companies that are excluded from the down switchers sample on the basis that there were concurrent major transactions. The same filter excludes 17 companies from the up sample.

For the remaining 218 (56) companies, the switch to AIM (MM) was not swamped in significance by other concurrent announcements. In most cases, the announcement to switch is accompanied by a short statement rationalising the decision. Most point to the lower costs (both financial and “continuing obligations”); many companies claim that AIM is a more appropriate market for a company of their size (“greater likelihood of attracting longer-term investor support”); and some companies point to the lower cost of future corporate transactions (as AIM does not charge for subsequent issues).

The flow of these switchers can be seen in Figure 1, along with the evolution of the market indices. This shows an interesting pattern: in the early days of AIM the switches tended to be “up” to the MM, whereas from the end of 2000 onwards the flow has been very strongly in the opposite “down” direction. The graph does not suggest any obvious relationship between the relative performance of the two market segments and the gross, or net, flows of companies.

Summary statistics for the final sample are presented in Table I. The market capitalisation of firms at the point they switched to AIM varies a great deal. The largest company had a market value in excess of £500m, and a few such large companies result in the average market capitalisation of £21m being considerably above the median of £8.6m. As noted above, there is no ongoing market capitalisation requirement for the MM, and so none of these companies were required to transfer to AIM.<sup>18</sup>

The median announcement date for the companies occurs 32 days prior to the switch to AIM occurring. There are also a few companies in the sample who made the first announcement several months before the actual switch, resulting in a mean lag between announcement and switch of 42 days. Table I also includes information on the percentage of firms making other concurrent announcements when announcing their intention to switch to AIM. As noted earlier, it is quite common for companies to provide updates on their trading when they announce the switch to AIM; this occurred in 32% of our

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<sup>18</sup> In contrast, the analysis of Angel *et. al.* (2004) considers only those firms who violated one or more of NASDAQ’s listing requirements. In their sample, the mean (median) market capitalisation of firms at the point of delisting was considerably smaller, at \$12.7m (\$4.4m) respectively.

sample. Announcements of actual or potential listing rule violations are rare: these occur in only 2% of the firms in our sample. Announcements regarding minor transactions are somewhat more common: 12% of the companies also announce small share issues or other capital restructurings, and 7% announce actual, or intended, acquisitions or disposals. 52% of companies made no other simultaneous announcements.

In the case of those switching up to the Main Market the gap between announcement and switching is slightly longer, on average 62 days with a median of 44 days. Half the companies simultaneously announced financial results, thus a smaller proportion (38%) of the announcements were purely about the intention to switch. Not surprisingly, the average size of those companies switching up is much larger than those switching down: median (mean) market capitalisation for the up switchers is around £103m (£175m).

### **III. The impact of switching markets on valuation**

#### *A. Methodology*

The standard technique employed to analyse the effects of events such as the one we consider is the event-study methodology pioneered by Fama, Fisher, Jensen and Roll (1969). Generally, researchers investigate return effects for both the announcement date (identified as described above), and the implementation date (we call this the 'switch date,' as firms stop trading on the MM, and switch to trading on the AIM market on this date). Using both the announcement and switch dates, we line stocks up in event time, and analyze their abnormal returns over a 52-week window surrounding the event. We divide up this event window into various blocks of weeks prior to, during and after the event week: [-26,-14], [-13,-2], [-1,0,+1], [+2,+13] and [+14,+26]. At this stage we employ a data-availability filter: we require all companies to have weekly returns available for at least 20% of the event window. This results in four very thinly traded companies being excluded from each of the down and up switchers samples, thereby reducing the final sample used in the remainder of the paper from 218 to 214 companies switching down, and 56 to 52 companies switching up.

Table II presents summary statistics about the raw return data we employ. Panel A shows these data for the down switchers. On average, these stocks slightly underperform the FTSE All Share index in the six months before the announcement period. However, in the three week period around the actual announcement (that is, [-1, 0, 1]) the mean (median) return is -5.1% (-2.3%), whereas average market returns were close to zero. An additional, but much smaller, negative return is experienced around the date of the actual switch: when the data are lined up around the switch date, the mean (median) return is -1.3% (-0.7%) in the three week period around the week of the switch. However, in the six months following the switch, they exhibit a cumulative return of 17.8% on average. Panel B reveals almost the reverse pattern for up switchers. These stocks perform strongly in the six months prior to announcing their switch from AIM to the Main market, with a mean (median) cumulative return of 21% (11%). They experience a further 4.8% boost upon announcement of the switch in the three weeks surrounding the announcement. This is then followed by negative -3.4% in the six months post-switch. Of course, the market movements over the period and the risk-factor loadings of the firms must be taken into account. Table II reveals that the FTSE All Share index exhibits quite different behaviour in event time across up and down switchers, which might be the proximate determinant of some of these patterns. To go further, we must risk adjust, and compute cumulative abnormal returns, to see if these intriguing patterns persist once these factors have been accounted for.

We construct the abnormal returns in two steps. First, we estimate event parameters over an estimation window using a factor model. We employ Carhart's (1997) four factor model, using the FTSE All-Share index as our proxy for the market, and SMB, HML and Momentum (UMD) factors constructed using all FTSE All-Share index constituents over the sample period.<sup>19</sup> We regress each firm's stock returns on the four factors in a 52-week estimation window prior to the event window, that is, [-78,-27]. We employ the Dimson (1979) correction in our regressions, to mitigate potential biases arising from non-synchronous trading. Writing  $r_{i,t}$  for the returns of firm  $i$  at date  $t$  in the estimation window, we estimate:

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<sup>19</sup> We have also employed a range of alternative factor models, including simple market adjustment using both the FTSE All-Share and the AIM indices, a one-factor market model, and a two-factor model using both the FTSE All-Share index and the AIM index. Our results are qualitatively unaffected by these different methods of risk adjustment – Figures 2 and 3 include these alternative CARs.

$$r_{i,t} = \alpha_i + \sum_{k=-1}^1 \beta_{i,FTSE}^k r_{FTSE,t+k} + \beta_{i,SMB}^k r_{SMB,t+k} + \beta_{i,HML}^k r_{HML,t+k} + \beta_{i,UMD}^k r_{UMD,t+k} + \varepsilon_{i,t} \quad (1)$$

where:

$$\begin{aligned} \beta_{i,FTSEDIM} &= \beta_{i,FTSE}^{-1} + \beta_{i,FTSE}^0 + \beta_{i,FTSE}^{+1} \\ \beta_{i,SMBDIM} &= \beta_{i,SMB}^{-1} + \beta_{i,SMB}^0 + \beta_{i,SMB}^{+1} \\ \beta_{i,HMLDIM} &= \beta_{i,HML}^{-1} + \beta_{i,HML}^0 + \beta_{i,HML}^{+1} \\ \beta_{i,UMDDIM} &= \beta_{i,UMD}^{-1} + \beta_{i,UMD}^0 + \beta_{i,UMD}^{+1} \end{aligned}$$

We then save the estimated parameters  $\hat{\beta}_{i,FTSEDIM}, \hat{\beta}_{i,SMBDIM}, \hat{\beta}_{i,HMLDIM}, \hat{\beta}_{i,UMDDIM}$  for each firm.

Table III shows summary statistics of these estimated parameters. On average, down switchers have positive loadings on SMB and a negative loading on HML, reflecting the fact that the returns of these firms co-move with those of small growth firms (there are a number of internet/computer software companies in the sample, although the sample is fairly balanced between old and new economy firms). Up switchers also have positive loadings on SMB, and strongly positive loadings on UMD, reflecting their strong momentum in the year prior to the event window.

To create abnormal returns, we subtract the estimated fitted value from realized firm returns for dates  $t$  in the event window:

$$r_{i,t}^{abnormal} = r_{i,t} - \hat{\beta}_{i,FTSEDIM} r_{FTSE,t} - \hat{\beta}_{i,SMBDIM} r_{SMB,t} - \hat{\beta}_{i,HMLDIM} r_{HML,t} - \hat{\beta}_{i,UMDDIM} r_{UMD,t} \quad (2)$$

Note that we do not subtract off the estimated  $\hat{\alpha}_i$  for each firm, i.e., we set it to zero when computing abnormal returns. We do so since we are interested in abnormal returns relative to factor loadings, rather than abnormal returns relative to past outperformance by the firm.<sup>20</sup>

We then sum computed abnormal returns over the event window, to create cumulative abnormal returns (CARs). These CARs are a measure of abnormal price increases. We then test whether the CARs are statistically different from zero around the announcement and switch dates. In order to do this, we

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<sup>20</sup> The estimates of  $\hat{\alpha}_i$  for the up switchers, tend to be large, reflecting strong pre-announcement performance by these firms. Thus, abnormal returns in the event window, especially for the up-switchers, tend to be quite negative when these estimates are incorporated, by construction. Our results for the down switchers are unaffected by the inclusion of these estimated intercepts when constructing abnormal returns. All of these results are available on request.

estimate standard errors for the point estimates in two ways. First, we employ the White (1980) method, estimating heteroskedasticity consistent standard errors. Second, we employ the delete-cross-section jackknife estimator, in the spirit of Shao and Wu (1989) and Shao (1989).<sup>21</sup> The jackknife does not require normality, is consistent in the presence of heteroskedasticity and cross-correlation of firm returns in event time. This is equivalent to clustering all firm residuals in each event time period.

### *B. Baseline Results*

Table IV presents the CARs for the switching firms estimated in the year around the event. Panel A reveals that on average, relative to the four factor model, the firms that switched down experienced a CAR of around -4% in the three weeks surrounding their announcement of a move from the LSE main market to the AIM market. This point estimate is statistically significant at the 5% level using both White and jackknife standard errors. Intriguingly, this negative return is then reversed in the six months following the switch, with CARs of over 9% in each of the [+2,+13] and [+14,+26] windows.

Figure 2 reproduces these results, along with CARs using three alternative risk-adjustment models. The first simply market-adjusts the returns, subtracting off the FTSE All-share index returns in event time. The second market-adjusts using the returns on the AIM index. The third employs a ‘two-factor model’, which estimates the loadings of firm returns on both FTSE All-share and AIM index returns over the estimation window, and subtracts off the product of the estimated factor loadings and the realized returns on the two indices during the event window. The figure shows that regardless of the method of risk adjustment that is employed, the pattern of negative announcement effect and subsequent strong bounce following the switch is clearly evident. On average, after a few months the bounce cancels out any negative return impact of the switch to the AIM market. This is a surprising pattern, since one might expect the anticipated impact of the switch between markets to be capitalised into share prices at the announcement date, especially since (as noted earlier) the decision to switch did not need shareholder approval. We look carefully at possible explanations for this pattern later in the paper.

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<sup>21</sup> To compute the jackknife standard error for an estimator, we form the estimator for  $T$  delete-cross-section jackknife data samples, constructed by deleting all stocks  $i$  for each event time period  $t$  in  $T$ . The standard deviation of the resulting jackknife trials, appropriately scaled, is the jackknife standard error of the estimator.

Panel B of Table IV shows the corresponding results for firms that switched in the opposite direction, up to the MM from the AIM market. The up switchers have significantly positive CARs in the weeks before and immediately after the announcement. Once the switch takes place, however, average CARs are negative, although this dip is not statistically significant. A visual representation of these results (which also shows the results using the three alternative risk-adjustment techniques), is presented in Figure 3. Relative to the down-switchers, the length of time between announcement and switch is both longer and more varied for the up-switchers. Therefore, the difference between Panels A and B are more pronounced than in Figure 2. Our conclusions regarding the up-switchers are inevitably more tentative, given the relatively small sample. But, on average, the positive announcement effect is followed by a significant upward drift in the weeks before the actual switch occurs and then broadly neutral performance in the subsequent six months.

In summary, the announcement of a switch down to AIM results, on average, in a raw return of -5% and a CAR of around -4%. These negative returns are economically and statistically significant, and would, viewed in isolation, raise the question as to why management decided to switch market segments. The returns continue to be negative in the following few weeks until the actual switch takes place, but these negative CARs are not generally significant. These results square with the intuition that the switch conveys negative information about the future earnings prospects of switching firms. However, the immediate and sustained reversal in performance in the period after the actual switch is surprising and warrants further analysis, which we undertake in the next section. The results we obtain for the up switchers are broadly the opposite, although, given the smaller sample, the results are not as well determined. We find that companies switch up after strong performance, and that the announcement effect generates average raw returns and CARs of around +6%. This is followed by continued positive returns until the actual switch, and thereafter performance ranges from neutral to somewhat negative, depending on the risk-adjustment benchmark.

C. *What explains the results?*

One possible explanation for the pattern of returns that we observe is the impact of deletion from and inclusion into share price indices. These effects have been well-documented in the literature (see Shleifer (1986) and Harris and Gurel (1986)). This is potentially relevant to this study as when a company ceases to be on the Main Market it is no longer eligible for certain indices (such as the FTSE All Share index), although once it switches to AIM it becomes eligible for alternative indices (such as the FTSE AIM index). However, while the removal from an index is immediate once the eligibility criteria are no longer satisfied, new candidates for index inclusion are only considered periodically (typically every three months). Therefore, when a company announces its intention to switch from the MM to AIM, the shares may be discounted in anticipation of the index removal at the point of the switch. However, any subsequent inclusion in the indices post-switch will depend on the date of the switch relative to the revision cycle for index composition. Hence, when the entire portfolio of switchers is analysed in event time, the likely positive impact of index inclusion will be averaged out over several months, which may explain the steady upward drift in returns.

To test this hypothesis we determined the dates when index changes were made for the companies in our sample. The indices we consider are the FTSE AIM, FTSE Fledgling, FTSE Small Cap, FTSE All Share, FTSE 250 and the Hoare-Govett Small Companies. Together, these indices constitute the major small company indices in the UK market. We then set the returns in the three-week period surrounding any index inclusion or deletion event to zero and re-estimate the CARs. This results in 612 (573) firm weeks being excluded in respect of index deletions (inclusions). The results are presented in Table V, where event time is measured relative to the switch date. For both up- and down-switchers the results are very similar to those presented in Table IV: for down-switchers the post-switch CARs grow to around +20% six months after the switch, and for the up-switchers the returns are slightly negative (and still lack statistical significance). This suggests either that the effects documented in the literature are swamped by the event of switching market segments, or that index inclusions and deletions are not as important for small companies as they are, for example, for companies entering and leaving the S&P 500.

Either way, the significant positive post-switch CARs are not explained by index inclusion and deletion effects.<sup>22</sup>

The second hypothesis we explore is whether the pattern of returns we observe could be influenced by significant changes in ownership around the switch date. For instance, if the announcement of the intention to switch caused some significant investors to sell, or buy (if, for example, institutional investors are restricted in their mandates to holding “listed” shares), this could have a price impact as positions were sold or bought. This could be especially important in this study since, as noted earlier, most of the companies have a relatively modest market capitalisation, and average annual turnover in the down (up) sample is 48% (59%) per week in the year prior to the announcement to switch markets.<sup>23</sup> Consequently, if an investor wanted to sell or buy a sizeable position, this might take several weeks to execute, possibly generating the observed pattern of returns.

To investigate this hypothesis we obtained detailed information on the significant ownership stakes of a sub-set of our companies.<sup>24</sup> In the U.K. stakes above 3% have to be declared, as do the shareholdings (of any magnitude) of directors. Any changes in such stakes have to be reported immediately, and so we are able to track changes in ownership very accurately in event time.

Figure 4 shows that the aggregate ownership proportions of major shareholders and directors around market switches are remarkably stable. For both up- and down-switchers, the directors of the firm hold about 15% of the equity in aggregate, and there is, if anything, a modest increase in this aggregate holding for down-switchers in the weeks before the actual switch, and a similarly modest reduction in holdings in the case of up-switchers. Thereafter, directors’ holdings change very little in aggregate. In the case of outside major shareholders, aggregate holdings are very stable in the period before the switch, and

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<sup>22</sup> Note that the first two columns of results for the up-switchers are identical in Tables IV and V, as the up switchers all remain on the FTSE AIM index until the date of the switch. Immediately following the switch, these firms are all deleted from the index.

<sup>23</sup> For comparison, the average annual turnover for the smallest size quintile of stocks on the NYSE is 55% over the 1993-2000 period (see Campbell, Ramadorai and Schwartz (2008)).

<sup>24</sup> We are extremely grateful to Tehmina Khan for making this data available to us. Because of some limitations in the coverage of firms, the Hemscott data upon which we rely was only available for 119 of the down-switchers and 32 of the up-switchers.

there appears to be little systematic selling or buying between the announcement date and the actual switch.<sup>25</sup>

The one interesting trend is that for down-switchers there is a small increase in aggregate institutional holdings in the six months following the switch to AIM, from 23% to nearly 25%. While such an increase could not explain the upward drift in returns post-switch, it suggests that institutional investors are not abandoning companies once they switch to lower-regulation markets. Overall, this evidence on ownership changes around the market switch is striking more for the stability in the shareholdings of significant investors, than for any changes in their positions over the period following the switch, and so does not provide an explanation in itself for the pattern of returns.

The final hypothesis we investigate is whether there is any evidence of changes in real operating performance after the switch between markets. As noted earlier, many of the companies that chose to switch from the MM to AIM cited the direct and indirect costs of the regulatory regime. If this was indeed the case, the cost reduction from switching down should, ultimately, show up in operating performance as reported in companies' annual accounts.

Consequently, we focus on analyzing whether the switch affected firms' earnings before interest, taxation, depreciation and amortization (EBITDA).<sup>26</sup> EBITDA is a good proxy for cash-flow (provided depreciation and capital expenditures are roughly equal) and tends to be reasonably comparable over time. We normalize EBITDA by the book value of total assets in order to obtain a measure of the rate of return. This information can be obtained for most, but not all, of the companies in our sample, and in Table VII we report the results for the five years around the switch. Note that since we are relying here on data from annual accounts, the timing of the accounting years and event time will vary across companies, but in all cases we follow the convention that the reported figures derive from the last published accounts prior to the event year. Thus year zero in the operating performance analysis is last full fiscal year prior to the year in which the firm announced its intention to switch market segments.

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<sup>25</sup> The figures we report are aggregated across all investors holding more than 3% stakes, but the stability in the aggregate reflects few changes in the underlying individual holdings, rather than significant selling and buying activity that nets out.

<sup>26</sup> We prefer this measure to reported measures of profitability, which can be influenced by all sorts of provisions, non-cash items or accounting conventions on amortization.

Starting with the down-switchers we see that total assets fell, on average, between years -2 and -1, but then remained remarkably constant thereafter. However, the pattern of EBITDA is intriguing, falling on average in 3 years before the switch, and then rising quite sharply after the switch. This results in a noticeable pattern in our measure of the rate of return, which we show graphically in Figure 5. On an asset weighted basis, EBITDA/Total Assets averaged only 1.3% in the last accounts published before the switch to AIM, but had recovered to 7.4% two years later. A similar pattern is observed in the unweighted average return, which increases from 0.1% to 3.9%. There are clearly many other ways to measure operating performance, but this evidence suggests that, on average, financial performance improves significantly after the switch to AIM. It is difficult to know to what extent this explains the steady upward drift in CARs post-switch. While we observe annual snapshots of operating performance from the accounts, our evidence on returns stretches out to six months after the switch. This six month period would, for some companies, encompass the first post-switch set of annual accounts but for many companies neither the accounts dated +1 or (of course) +2 would have been published. But presumably investors will have received higher frequency information from trading updates and equity analysts, which may have changed expectations of future performance well before the formal results were published. Of course, investors' valuations may depend on many other performance measures, and we have only presented evidence on one such measure. All we can say is that evidence certainly exists that one key measure of operating performance improved quite significantly after the switch to AIM, and that if such improvements only became apparent (and were built into investors' expectations) in the months after the switch, the pattern of returns we observe – with significant positive CARs post-switch – may be consistent with a standard valuation model.

The operating performance of the up-switchers is quite different. These companies exhibit, on average, strong and consistent growth in total assets, from £35m two years before the switch to £181m two years after the switch. EBITDA fluctuates with no obvious pattern, and the asset-weighted-average rate of return is almost the same in year -2 as in year +2. The main conclusion we draw from this sample is that firms that switch up to the MM do so in anticipation of a significant increase in the scale of their activities.

In summary, in this section we have explored some possible explanations for the observed post-switch performance, in particular for the down-switchers, where significant positive CARs are observed in the six months after the switch. We find that the results are not driven by index inclusion/deletion effects, nor are they driven by changes in the stakes held by large shareholders. However, we do find that operating performance for the down-switchers improves significantly in the two years post-switch, and the observed positive returns are consistent with investors gradually revising their expectations regarding valuation in the months after the switch as new information becomes available. Clearly, if such performance improvements became widely understood and predictable, we would expect the pattern of returns to flatten out and eventually be captured on the announcement date. As far as we are aware, our paper is the first to analyse the share price and operating performance of companies that switch between the London markets.

#### *D. Robustness Checks*

In general, the switch between markets that we focus on in this paper is a very clean form of event-study, where the main change is in the nature of regulation. However, we encountered two complications – contemporaneous announcements and changes in the tax regime – and in this section we investigate whether our main results are influenced by these issues.

As noted in section II, the announcement that the firm is going to switch markets is often accompanied by other news, such as updates on operating performance or minor corporate transactions. We excluded *ab initio* any companies for which the concurrent announcements were judged to be significant, and so might contaminate our analysis. However, the results reported to date include those companies that made other more minor announcements – such as routine updates on performance, small disposals or acquisitions etc. – at the same time that they announced their intention to switch market. As a robustness check, we re-ran the analysis having removed the 38 (7) firms from the down (up) switching sample that made such simultaneous announcements. Our results are hardly affected by this robustness check: for instance, the negative (positive) announcement effects remain for the down (up) switchers, and

the post-switch CARs for the down-switchers reach +19.7% after six months, compared with the +19.0% reported in Table IV.

Regarding the possible impact of changes in the tax regime on our results, we repeated our earlier analysis, but split the sample according to the three tax regimes we identify in the Appendix (namely, pre-5 April 2000; 6 April 2000-5 April 2002; and 6 April 2002 onwards). This results, inevitably, in the size of the sample not being evenly spread between the sub-periods. In particular, nearly 70% of our sample of down-switchers did so in the most recent tax regime, whereas nearly 60% of the companies switching up did so in the first tax regime. Bearing in mind the limited samples upon which some of the estimates are based, the results, presented in Table VII, exhibit no obvious differences between the various tax regimes. This suggests that the results we identify in this paper are associated with the more general governance and regulation differences between the two market segments.

#### **IV. Discussion and conclusions**

In this paper we examine the consequences of switching between markets with different regulatory standards. To address this question, we exploit the unique environment that exists in London, where there are two markets with different levels of regulation that use identical trading technology. London has seen a large number of companies that have chosen to switch between the Main Market and AIM, which provides us with an excellent test-bed for analysing the impact of high versus low levels of regulation on firm value. We also present evidence on the operating performance post-switch. Our analysis is highly pertinent to current debates in the U.S. and E.U. regarding the appropriate extent of regulation given the observed flight of many companies away from highly-regulated markets, and may also help to provide an explanation for the enormous growth in the popularity of AIM.

We find large and significant announcement effects associated with the decision to switch market. Companies move from AIM to the Main Market, in general, following periods of strong performance, and when they announce the switch, they experience a positive return of around 6%. Thereafter, the CARs are broadly neutral, although some forms of risk-adjustment generate mildly negative returns.

For those switching down to AIM we observe immediate effects averaging around -4%. There is clear evidence, therefore, that the initial response of investors to the news of a switch is negative. Intriguingly, however, this is not the end of the story. There is typically a gap of about 30-40 trading days between the announcement of the intention to switch and the move to AIM actually occurring. We demonstrate that there is a prolonged and significant bounce in the share prices once the companies start trading on AIM. The estimated abnormal returns differ somewhat depending on which factor model is employed, but generally approach +20%. This outperformance occurs over the six-month period following the switch date. The net result, looking at a wide event window of six months before and after the switch, is positive. Similar conclusions would apply if the event window was narrowed to three months on either side of the switch.

We investigate whether this pattern of results is driven by index inclusions and exclusions over the event period, or to the sale and/or purchase of large blocks of shares by insiders and institutional investors, and conclude that the evidence supports neither hypothesis. On the other hand when we investigate the actual operating performance of the switching companies, we find significant improvements in performance in the two years following the switch down to AIM. The steady increase in CARs in the post-switch period for those switching to the less-regulated environment of AIM is certainly consistent with the hypothesis that investors gradually learn about this improved operating performance and share prices respond accordingly. Given that the performance improvement that we report occurs over the two-year period following the switch, it is not surprising that it was not fully anticipated at the switch date. However, should such improvements become anticipated as the norm, then the announcement effect might well reverse and become positive.

Overall, our results suggest that the most suitable regulatory regime may differ across companies. In the case of smaller quoted companies – of the sort that we focus on in this paper – the dominant flow in the UK in the last decade has been away from the Main Market to the more lightly regulated AIM. Our results suggest that the management of the companies that switched to AIM were not, in general, acting against the interests of their shareholders, notwithstanding the initial negative announcement effect. The operating performance of the companies within the less-regulated environment was, on average,

significantly improved and within a few months of the switch the share prices had more than recovered. Such results suggest that the less regulated market segments that have been created in many countries may well flourish.

## Appendix

The main differences between the requirements imposed on companies – both at admission and on an ongoing basis – are summarized in Table A1.

**Table A1**  
**Comparison of the Main Market and the Alternative Investment Market**

<b>MAIN MARKET</b>	<b>ALTERNATIVE INVESTMENT MARKET</b>
<b>Admissions requirements</b>	
Minimum 25% shares in public hands	No minimum shares in public hands
Normally 3 year trading record required	No trading record requirement
Pre-vetting of admission documents by the UKLA, or another recognised EU authority	Admission documents not pre-vetted by Exchange or any listing authority
Admission takes several months	Admission can be achieved within 2 weeks
Minimum market capitalisation on entry (£700K)	No minimum market capitalisation Nominated adviser required at all times
Sliding scale admission fees: e.g. £16K, £49K, £142K respectively for £10m, £100m and £1bn market cap at issue	Flat rate admission fee: £4K
<b>Continuing Obligations</b>	
Prior shareholder approval required for substantial acquisitions and disposals	No prior shareholder approval for transactions
Sponsors needed for certain transactions	
Companies are subject to extensive continuing obligations as required by the UKLA	
Sliding scale annual fees: e.g. £8K, £8K, £20K respectively for £10m, £100m and £1bn market capitalization stocks	Flat rate annual fee: £4K
<b>Other Costs and Benefits</b>	
Fees charged for subsequent issues	No charge for subsequent issues
	Aim companies enjoy some tax benefits - since UK tax authorities treat most AIM companies as unquoted “business” assets

Most of these differences are self-explanatory. The most complex issues relate to taxation. A decision was implemented in 2000 to treat AIM companies as “unquoted”, which resulted in them receiving a similar tax treatment to privately-held companies. There are advantages and disadvantages to this tax treatment:

the first main advantage is that most AIM companies are treated as “business assets” which benefit from lower rates of capital gains tax (CGT) if they are held for a number of years.<sup>27</sup> This “taper relief” has varied in generosity and timescale during our sample period. When taper relief was first applied to AIM companies in April 2000, investors’ CGT liability was reduced by 12.5% for each of the first two years they held an investment, and by 25% for the next two years, therefore reaching a maximum of 75% after 4 years. The speed with which taper relief accrues was increased from April 2002 so that the maximum relief is achieved after a holding period of just 2 years.<sup>28</sup>

Clearly this is only of benefit if the investors are liable to CGT and are taxed in the UK. Many investors are tax-exempt and for such pension funds, endowments etc. the relief has no impact. However, for individuals (who are subject to taxation in the UK) the relief could be of value. The CGT rate has (since 1999) been aligned with the tax rates on interest and dividend income with basic and higher rate taxpayers paying 20% and 40% respectively. At these rates, and with the original taper schedule, the impact of taper relief on a higher-rate taxpayer was to reduce the CGT rate after 4 years to 10%. However, it is important to note that generous annual exemptions exist for individuals regarding capital gains: in 2000 the first £7200 of capital gains were tax-free. This reduced the effective marginal rate of CGT to zero for most individuals, and therefore the benefits of taper relief mainly accrued to entrepreneurs (with significant stakes in affected businesses) and wealthy individuals who regularly realised capital gains larger than the annual exemption.

The second potential advantage to individual investors is that AIM companies can be included in Venture Capital Trusts (VCTs), which are portfolios of smaller, more speculative investments. Individuals can offset investments in VCTs against income tax, and obtain certain other benefits. However, the maximum size of company that is eligible to be included in a VCT, and the size of the minimum stake that is required, imply that few existing companies are likely to attract VCT investment on switching to AIM. A third advantage is that holdings of AIM companies are exempt from Inheritance Tax, although again the

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<sup>27</sup> Only that proportion of a company’s assets that are “business” assets – those associated with trading – is eligible to benefit from capital gains tax taper relief. Non-business assets – such as securities in quoted companies – are not eligible for taper relief.

<sup>28</sup> More information on CGT rates and reliefs can be found at [www.hmrc.gov.uk/stats/capital\\_gains/00ap\\_a7.htm](http://www.hmrc.gov.uk/stats/capital_gains/00ap_a7.htm)

value of this to individual investors will depend upon whether they are liable to inheritance tax (in addition to a sizeable zero-rate allowance, there are well-established ways to reduce inheritance tax liability). There are certain other tax benefits which apply to investors in AIM companies, but these are associated with shares issued at an IPO, or were held prior to the IPO, and so do not apply to companies switching markets after the IPO.

Against these potential benefits, there is at least one important tax disadvantage associated with AIM companies. In particular, since 2006 – the last year of our sample – shares in AIM companies cannot be included in tax-favoured Individual Savings Accounts (ISAs). Individuals can invest around £7000 a year in such accounts, which typically invest in a portfolio of shares or bonds. Consequently, any investment management companies running portfolios funded by ISAs would have to dispose of their holdings in any company switching down to AIM.

It is difficult to judge the net impact of these tax issues. Clearly, the impact will differ according to the tax status of individuals investing in AIM companies. However, due to the various exemptions and tax planning opportunities that exist for individual investors – which reduce the value of the tax benefits significantly – and the fact that the benefits only accrue in the (uncertain) event of capital gain, we would anticipate that the impact on share prices would be negligible. Furthermore, it seems unlikely that the relevant marginal investor will be an individual investor, rather than an institutional investor to whom these tax distinctions do not apply. Nevertheless, Table VII shows results from a robustness check to see whether the impact of switching differed across the three main tax regimes associated with CGT (pre-5 April 2000; 6 April 2000-5 April 2002; and 6 April 2002 onwards).

In Table A2 below we document the growth of the AIM market since its inception in June 1995.

**Table A2**  
**The Growth of the AIM Market**

This table shows the development of the AIM market since its inception. Ten companies previously on the Unlisted Securities Market were transferred to AIM when it opened in June 1995. The first block of columns shows the total number of companies quoted at the year end; international companies are those from outside the UK. New admissions comprise IPOs and transfers from the Main Market (MM). We do not report those companies that left the market – either due to takeovers, switches to the MM, or cancellations – although this flow can be inferred from the difference between the first two blocks of figures. Money raised is split into funds raised at the time of the IPO or on transfer from the MM (Initial Issues), and further issues by AIM quoted companies. Source: London Stock Exchange AIM market statistics, December 2006.

Year	Quoted Companies		New Admissions		Capital Raised (£MM)		
	Total	...of which International	Total	... of which International	Initial Issues	Further Issues	Total
1995	121	3	123	3	69.500	25.300	94.800
1996	252	17	145	14	514.100	302.300	816.400
1997	308	22	107	7	344.100	350.200	694.300
1998	312	21	75	7	267.500	290.100	557.600
1999	347	22	102	6	333.700	599.800	933.500
2000	524	31	277	12	1,754.100	1,319.700	3,073.800
2001	629	42	177	15	593.078	535.280	1,128.357
2002	704	50	160	13	490.056	485.759	975.815
2003	754	60	162	16	1,095.428	999.730	2,095.158
2004	1021	116	355	61	2,775.885	1,880.250	4,656.135
2005	1,399	220	519	120	6,461.231	2,481.208	8,942.439
2006	1,634	306	462	124	9,943.842	5,734.280	15,678.122
Total			2,664	398	24,642.519	15,003.908	39,646.427

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**Table I**  
**Characteristics of the Sample**

This table shows the sample of companies that switched from the Main Market to AIM (top panel), and from AIM to the Main Market (bottom panel), between 1995 and the end of 2006. Companies that made major acquisitions or disposals – the impact of which would dominate the switch – have been excluded from the sample (see discussion in Section II for details). Companies are classified by year according to the date of the first public announcement of their intention to switch, rather than the date of the actual switch. Days pre-announced refers to the gap between the first public announcement of the intention to switch market segments and the actual date of the switch. ‘Also Announced’ refers to items that were included in the regulatory news filing at the same time as the announcement of the intention to switch to AIM. As some companies made simultaneous announcements in more than one category these percentages do not add up to 100.

Main Market-AIM	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
N(Firms)	5	2	6	14	28	37	42	21	35	28	218
<u>Days Pre-Announced</u>											
Mean	32	22	30	35	48	35	42	52	57	67	42
Median	17	22	30	33	32	31	33	32	53	61	32
<u>Market Cap. on Transfer</u>											
Mean (£MM)	8.7	34.4	4.2	46.8	11.2	9.9	16.2	23.9	31.0	24.0	21.0
Median (£MM)	8.6	34.4	3.6	8.4	6.5	5.8	8.7	10.0	16.9	17.7	8.6
<u>Also Announced (% of sample)</u>											
Financial Results											32%
Listing Rule Violation											2%
Share Issue/Restructuring											12%
Minor Acquisition/Disposal											7%
No Announcement											52%
AIM-Main Market	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
N(Firms)	0	16	10	10	6	4	3	2	2	3	56
<u>Days Pre-Announced</u>											
Mean	0	42	38	63	110	57	59	44	128	85	62
Median	0	34	32	75	38	44	70	44	128	75	44
<u>Market Cap. on Transfer</u>											
Mean (£MM)		61.1	119.9	217.5	94.2	125.8	261.1	145.0	268.6	283.7	175.2
Median (£MM)		42.5	46.5	101.6	107.8	123.3	163.4	145.0	268.6	274.2	102.9
<u>Also Announced (% of sample)</u>											
Financial Results											50%
Listing Rule Violation											0%
Share Issue/Restructuring											11%
Minor Acquisition/Disposal											2%
No Announcement											38%

**Table II**  
**Summary Statistics for Weekly Returns**

This table presents descriptive statistics about the weekly return data employed in the study. The data comprise 214 firms which switched down from the London Stock Exchange Main Market (MM) to the Alternative Investment Market (AIM) between 1997 and 2006; and 52 firms which switched up from AIM to the LSE MM between 1997 and 2006. 4 thinly-traded companies are excluded from both the original samples that were summarized in Table I. The columns show the weeks in event time (relative to the announcement or actual switch week) over which cumulative returns are computed (thus [-26,-14] shows the total return from 26 weeks prior to the announcement/switch until 14 weeks prior to the announcement/switch). The rows present, in order, the cross-sectional mean, median and standard error of the mean of cumulative returns, and the average return (in event time) on the FTSE All-Share index. Panel A shows summary statistics for the Down switchers (Main to AIM), and Panel B for the Up switchers (AIM to Main).

**Panel A: Down Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Announcement is Week 0</u>					
Mean return	0.597	0.249	-5.132	0.926	10.518
Median return	0.681	-0.813	-2.273	0.143	6.265
s.e.(Mean)	2.412	2.571	1.552	2.361	2.362
Mean FTSE return	0.918	1.238	0.145	1.465	1.666
<u>Switch is Week 0</u>					
Mean return	-0.070	-4.600	-1.326	11.453	6.336
Median	-0.236	-4.653	-0.677	4.664	4.359
s.e.(Mean)	2.286	2.519	1.084	2.578	2.104
Mean FTSE return	1.035	1.483	0.370	1.409	1.791

**Panel B: Up Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Announcement is Week 0</u>					
Mean return	16.987	4.450	4.842	8.377	-0.775
Median return	10.756	0.687	2.546	4.007	4.542
s.e.(Mean)	7.467	3.988	2.804	4.968	4.182
Mean FTSE return	2.678	1.107	0.269	0.332	1.497
<u>Switch is Week 0</u>					
Mean return	8.093	4.963	5.654	-1.680	-1.676
Median return	12.185	0.832	1.623	-0.762	-0.096
s.e.(Mean)	4.347	5.609	2.041	4.806	4.536
Mean FTSE return	4.385	-0.617	0.523	0.169	1.892

**Table III**  
**Four-Factor Model Parameters in Estimation Window**

Table III presents descriptive statistics on the factor loadings of the firms estimated over [-78,-27] weeks prior to the announcement or switch. The data comprise 214 firms that switched down from the London Stock Exchange Main Market (MM) to the Alternative Investment Market (AIM) between 1997 and 2006; and 52 firms which switched up from AIM to the MM between 1997 and 2006. The columns show the intercept, Dimson-corrected betas (with a one week lead and lag), and adjusted R-squared statistics from a multiple regression of firm returns on three Fama-French factors constructed using weekly UK data (MKT, SMB and HML), as well as a Momentum factor (UMD). The columns present, in order, the cross-sectional mean, median, and standard error of the mean, of these parameters. Panel A presents these data for the Down switchers, and Panel B for the Up switchers.

**Panel A: Down Switchers**

<b>Parameters Estimated Over [-78,-27]</b>						
	Alpha	BetaFTSE	BetaSMB	BetaHML	BetaUMD	Adj. R-sq.
<u>Announcement is Week 0</u>						
Mean	0.001	0.588	1.009	-0.394	1.546	0.044
Median	0.001	0.487	0.859	-0.040	1.166	0.026
s.e.(Mean)	0.001	0.084	0.180	0.171	1.381	
<u>Switch is Week 0</u>						
Mean	-0.000	0.640	0.793	-0.261	1.083	0.037
Median	0.001	0.502	0.778	-0.069	1.138	0.015
s.e.(Mean)	0.001	0.084	0.169	0.162	1.309	

**Panel B: Up Switchers**

<b>Parameters Estimated Over [-78,-27]</b>						
	Alpha	BetaFTSE	BetaSMB	BetaHML	BetaUMD	Adj. R-sq.
<u>Announcement is Week 0</u>						
Mean	0.006	0.836	1.680	0.305	7.502	0.066
Median	0.003	0.436	1.172	0.152	2.862	0.078
s.e.(Mean)	0.002	0.241	0.556	0.523	3.786	
<u>Switch is Week 0</u>						
Mean	0.005	0.878	1.089	-0.360	6.627	0.118
Median	0.004	0.563	1.171	-0.146	0.580	0.120
s.e.(Mean)	0.002	0.208	0.484	0.491	4.326	

**Table IV**  
**Cumulative Abnormal Returns, From the Four-Factor Model**

This table presents four factor model-adjusted cumulative abnormal returns (CARs) in event time over [-26,-26] weeks surrounding the announcement and switch weeks. Estimated alpha from the four-factor model is set to zero when computing CARs. The data comprise 214 firms which switched down from the London Stock Exchange Main Market (MM) to the Alternative Investment Market (AIM) between 1997 and 2006; and 52 firms which switched up from AIM to the MM between 1997 and 2006. The rows show, in order, the cross-sectional mean factor-model-adjusted abnormal return in percent accruing in each of the return windows; T-statistics computed using White heteroskedasticity consistent standard errors; and T-statistics computed using cross-correlation and heteroskedasticity consistent jackknife standard errors for the CARs. All intercepts and betas are estimated over the 52-week period ([-78,-27]) prior to the beginning of the event window, and employ the Dimson correction. Panel A presents these data for the Down switchers, and Panel B for the Up switchers. CARs significant at the 5% level using the jackknife estimator are in **bold**, and CARs significant at the 10% level are underlined.

**Panel A: Down Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Announcement is Week 0</u>					
Cumulative Abnormal Returns	3.124	0.119	<b>-3.831</b>	2.240	<b>13.046</b>
	<i>1.210</i>	<i>0.049</i>	<i>-2.640</i>	<i>0.922</i>	<i>4.581</i>
	<i>1.099</i>	<i>0.062</i>	<i>-2.058</i>	<i>1.039</i>	<i>3.726</i>
<u>Switch is Week 0</u>					
Cumulative Abnormal Returns	2.773	-3.548	-0.739	<b>9.806</b>	<b>9.150</b>
	<i>1.133</i>	<i>-1.379</i>	<i>-0.585</i>	<i>3.861</i>	<i>3.552</i>
	<i>0.992</i>	<i>-1.245</i>	<i>-0.446</i>	<i>3.381</i>	<i>2.930</i>

**Panel B: Up Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Announcement is Week 0</u>					
Cumulative Abnormal Returns	<b>21.120</b>	1.059	<b>6.429</b>	<b>15.836</b>	5.356
	<i>3.142</i>	<i>0.211</i>	<i>2.227</i>	<i>3.105</i>	<i>0.899</i>
	<i>3.135</i>	<i>0.195</i>	<i>3.038</i>	<i>2.839</i>	<i>0.934</i>
<u>Switch is Week 0</u>					
Cumulative Abnormal Returns	<u>7.730</u>	<b>10.369</b>	4.253	-6.135	1.866
	<i>1.419</i>	<i>1.976</i>	<i>1.462</i>	<i>-1.188</i>	<i>0.279</i>
	<i>1.762</i>	<i>2.059</i>	<i>0.626</i>	<i>-1.075</i>	<i>0.427</i>

**Table V**  
**Cumulative Abnormal Returns, No Index Inclusions or Deletions**

This table presents four factor model adjusted cumulative abnormal returns (CARs) in event time over [-26,-26] weeks surrounding the switch week. Estimated alpha from the four-factor model is set to zero when computing CARs. The data comprise 214 firms which switched down from the London Stock Exchange Main Market (MM) to the Alternative Investment Market (AIM) between 1997 and 2006; and 52 firms which switched up from AIM to the MM between 1997 and 2006. We set returns in the three-week period surrounding index addition and deletion events (i.e., a [-1,0,1] window around such events) to zero. The indices we consider are the FTSE AIM, FTSE Fledgling, FTSE Small Cap, FTSE All Share, FTSE 250 and the Hoare-Govett Small Companies Index, which together constitute the main small companies indices in the UK. The rows show, in order, the cross-sectional mean factor-model-adjusted abnormal return in percent accruing in each of the return windows; T-statistics computed using White heteroskedasticity consistent standard errors; and T-statistics computed using cross-correlation and heteroskedasticity consistent jackknife standard errors for the CARs. The final two rows indicate the number of stock-weeks in which addition and deletion events occurred within the [-26,+26] window. All intercepts and betas are estimated over the 52-week period ([-78,-27]) prior to the beginning of the event window, and employ the Dimson correction. Panel A presents these data for the Down switchers, and Panel B for the Up switchers. CARs significant at the 5% level using the jackknife estimator are in **bold**, and CARs significant at the 10% level are underlined.

**Panel A: Down Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Switch is Week 0</u>					
Cumulative Abnormal Returns	2.740	-3.468	-0.662	<b>10.618</b>	<b>9.337</b>
	<i>1.135</i>	<i>-1.367</i>	<i>-0.534</i>	<i>4.614</i>	<i>3.733</i>
	<i>0.995</i>	<i>-1.212</i>	<i>-0.416</i>	<i>3.572</i>	<i>3.027</i>
Number of Firm-Weeks With Inclusions	573				
Number of Firm-Weeks With Deletions	611				

**Panel B: Up Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Switch is Week 0</u>					
Cumulative Abnormal Returns	<u>7.730</u>	<b>10.369</b>	5.345	-5.765	0.221
	<i>1.419</i>	<i>1.976</i>	<i>1.941</i>	<i>-1.136</i>	<i>0.034</i>
	<i>1.762</i>	<i>2.059</i>	<i>0.788</i>	<i>-1.027</i>	<i>0.051</i>
Number of Firm-Weeks With Inclusions	85				
Number of Firm-Weeks With Deletions	153				

**Table VI**  
**Operating Performance Around Switch**

This table presents statistics on operating performance in the years surrounding the year when firms switch market segments. The sample comprises 187 firms which switched down from the London Stock Exchange Main Market (MM) to the Alternative Investment Market (AIM) between 1997 and 2006; and 52 firms which switched up from AIM to the MM between 1997 and 2006, for which data on earnings before interest, taxes, depreciation and amortization (EBITDA) and Total Assets are available in the last complete fiscal year prior to the switch. We present statistics of these data in the [-2,+2] fiscal year window surrounding the switch (year 0 is the last complete fiscal year prior to the fiscal year in which the firm switched market segments). The rows show, in order, the number of firms for which data are available in each fiscal year; Mean Total Assets; Mean EBITDA; Mean EBITDA/Total Assets, trimmed for outliers which are greater than 100% in absolute value; and Mean EBITDA/Total Assets, untrimmed, and weighted by Total Assets. Cross-sectional T-statistics computed using White heteroskedasticity consistent standard errors are reported below coefficients in italics. Panel A presents these data for the Down switchers, and Panel B for the Up switchers. Numbers significant at the 5% level using the White estimator are in **bold**, and those significant at the 10% level are underlined.

**Panel A: Down Switchers**

	Fiscal Year Relative to Switch				
	-2	-1	0	1	2
N(Firms)	186	185	187	173	158
Mean Total Assets (£MM)	<b>54.356</b>	<b>39.410</b>	<b>39.193</b>	<b>40.039</b>	<b>38.243</b>
	<i>3.672</i>	<i>9.511</i>	<i>8.398</i>	<i>8.166</i>	<i>9.147</i>
Mean EBITDA (£MM)	<b>2.676</b>	<u>1.234</u>	0.532	<b>2.067</b>	<b>2.824</b>
	<i>2.768</i>	<i>1.824</i>	<i>0.505</i>	<i>3.302</i>	<i>3.841</i>
EBITDA/Total Assets (% , Trimmed)	<u>3.229</u>	2.337	0.134	<b>3.313</b>	<b>3.865</b>
	<i>1.899</i>	<i>1.522</i>	<i>0.075</i>	<i>2.334</i>	<i>2.616</i>
EBITDA/Total Assets (% , Asset Wtd)	<b>4.924</b>	<u>3.113</u>	1.344	<b>5.104</b>	<b>7.338</b>
	<i>2.768</i>	<i>1.824</i>	<i>0.505</i>	<i>3.302</i>	<i>3.841</i>

**Panel B: Up Switchers**

	Fiscal Year Relative to Switch				
	-2	-1	0	1	2
N(Firms)	39	50	52	52	47
Mean Total Assets (£MM)	<b>34.707</b>	<b>50.965</b>	<b>67.695</b>	<b>163.142</b>	<b>180.752</b>
	<i>2.579</i>	<i>4.281</i>	<i>6.953</i>	<i>2.892</i>	<i>2.681</i>
Mean EBITDA (£MM)	1.028	4.605	2.457	<b>9.679</b>	5.315
	<i>0.941</i>	<i>1.620</i>	<i>1.580</i>	<i>2.185</i>	<i>0.577</i>
EBITDA/Total Assets (% , Trimmed)	0.607	-0.521	3.002	0.969	-0.409
	<i>0.194</i>	<i>-0.140</i>	<i>0.899</i>	<i>0.275</i>	<i>-0.099</i>
EBITDA/Total Assets (% , Asset Wtd)	2.818	8.859	3.561	<b>5.821</b>	2.879
	<i>0.941</i>	<i>1.620</i>	<i>1.580</i>	<i>2.185</i>	<i>0.577</i>

**Table VII**  
**Cumulative Abnormal Returns, Tax Change Sub-Periods**

This table presents four factor model adjusted cumulative abnormal returns (CARs) in event time over [-26,-26] weeks surrounding the announcement and switch weeks. Estimated alpha from the four-factor model is set to zero when computing CARs. The data comprise 214 firms which switched down from the London Stock Exchange Main Market (MM) to the Alternative Investment Market (AIM) between 1997 and 2006; and 52 firms which switched up from AIM to the MM between 1997 and 2006. The sample is split into three sub-periods, stocks which switched between 1<sup>st</sup> January 1997 and 5th April 2000 (sub-period I); between 6th April 2000 and 5th April 2002 (sub-period II) and from 6th April 2002 until the end of 2006 (sub-period III). The rows show the cross-sectional mean factor-model-adjusted abnormal return in percent accruing in each of the return windows. All intercepts and betas are estimated over the 52-week period ([-78,-27]) prior to the beginning of the event window, and employ the Dimson correction. Panel A presents these data for the Down switchers, Panel B for the Up switchers, and Panel C shows the number of firms that announced their intention to switch market segments in each of the three sub-periods. CARs significant at the 5% level (tested using cross-correlation and heteroskedasticity consistent jackknife standard errors) are in **bold**, and CARs significant at the 10% level are underlined.

**Panel A: Down Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Announcement is Week 0</u>					
Cumulative Abnormal Returns Sub-Period I	-0.037	0.678	-2.237	10.756	<b>30.035</b>
Cumulative Abnormal Returns Sub-Period II	-3.767	<b>-13.619</b>	-5.726	-4.066	14.318
Cumulative Abnormal Returns Sub-Period III	<b>5.717</b>	<u>4.766</u>	<u>-3.255</u>	3.554	<b>10.752</b>
<u>Switch is Week 0</u>					
Cumulative Abnormal Returns Sub-Period I	2.008	6.959	-0.768	<u>22.329</u>	19.807
Cumulative Abnormal Returns Sub-Period II	-7.402	-12.667	-0.241	6.130	8.307
Cumulative Abnormal Returns Sub-Period III	<b>6.271</b>	-1.343	-0.892	<b>9.690</b>	<b>8.253</b>

**Panel B: Up Switchers**

	Weeks in Event Time				
	[-26,-14]	[-13,-2]	[-1,0,1]	[+2,+13]	[+14,+26]
<u>Announcement is Week 0</u>					
Cumulative Abnormal Returns Sub-Period I	<b>25.996</b>	8.944	<b>6.694</b>	<b>11.841</b>	-1.722
Cumulative Abnormal Returns Sub-Period II	17.069	-14.965	9.416	32.245	21.843
Cumulative Abnormal Returns Sub-Period III	<b>11.058</b>	-6.595	2.970	12.177	<b>10.315</b>
<u>Switch is Week 0</u>					
Cumulative Abnormal Returns Sub-Period I	<b>12.394</b>	<b>19.533</b>	0.901	-10.151	2.983
Cumulative Abnormal Returns Sub-Period II	1.043	-1.968	<u>12.112</u>	-3.911	-8.195
Cumulative Abnormal Returns Sub-Period III	0.241	-5.077	<u>6.857</u>	3.525	7.762

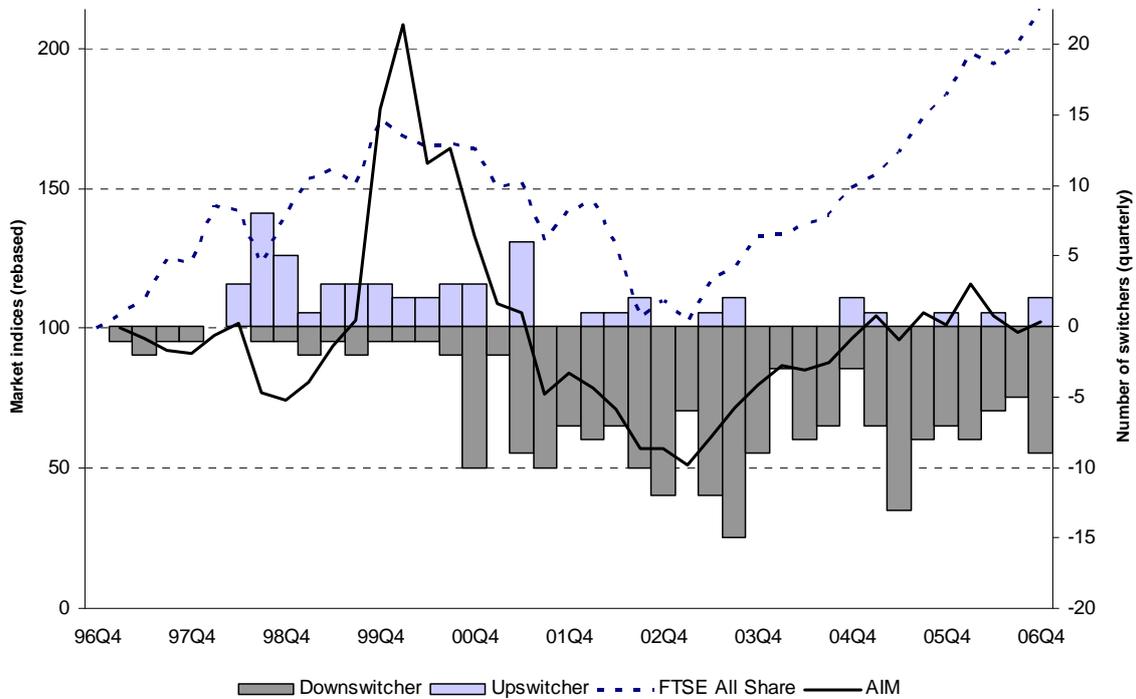
**Panel C: Number of Firms in Each Sub-Period**

Number of Firms Announcing in Each Sub-Period	I	II	III
Down Switchers	14	51	149
Up Switchers	31	10	11

**Figure 1**

**Performance of the Main Market and AIM, and the Number of Firms Switching Markets**

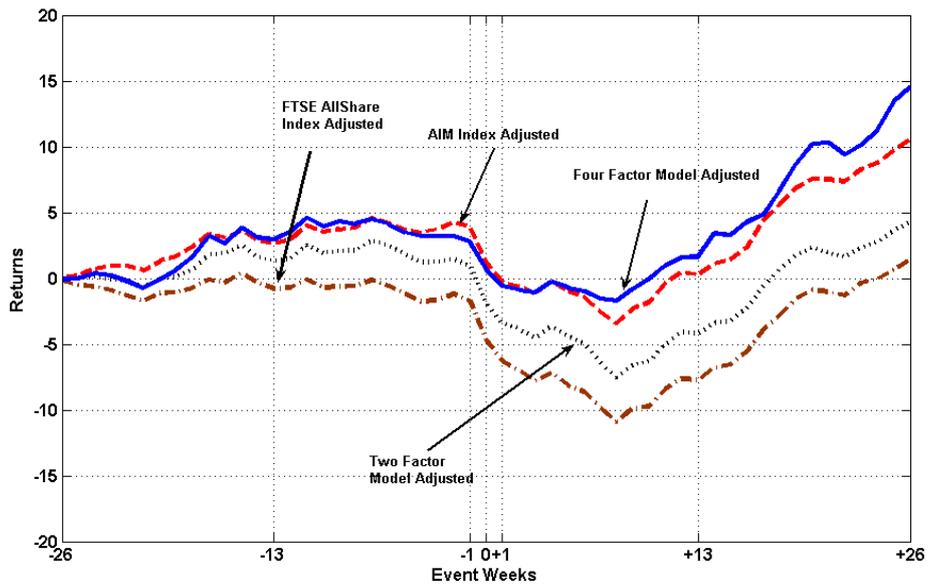
This figure shows the performance of the Main Market (as measured by the FTSE All Share Index) and AIM (as measured by the FTSE AIM Index), along with the number of companies switching between markets from 1997 until the end of 2006. Both market indices measure total returns, including reinvested dividends. The AIM index was introduced in May 1997. Companies are classified by quarter according to the date of the actual switch.



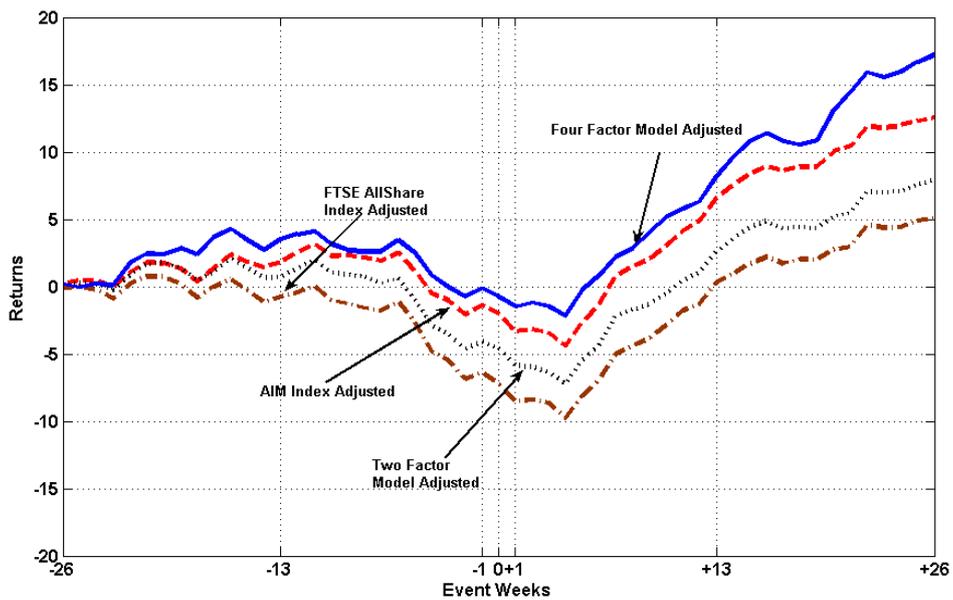
**Figure 2**  
**Cumulative Abnormal Returns: Down Switchers**

Panel A (B) of this figure plots cumulative abnormal returns for the firms switching from Main to AIM in our sample around the announcement (switch) dates. The CARs are constructed four different models: the four-factor model; a two-factor model comprising the FTSE All Share and AIM indices; and simple market adjustment using the FTSE All Share and the AIM indices.

**Panel A: Announcement Date**



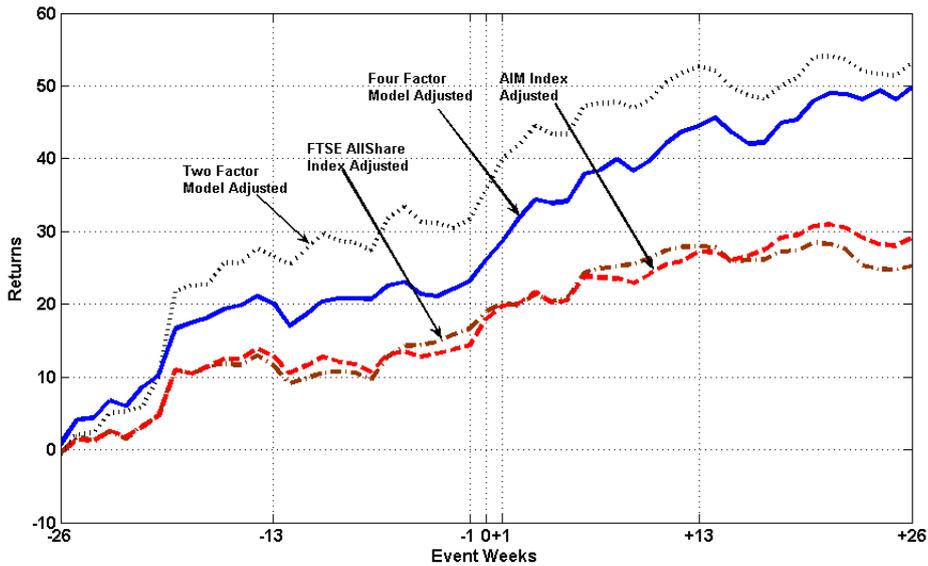
**Panel B: Switch Date**



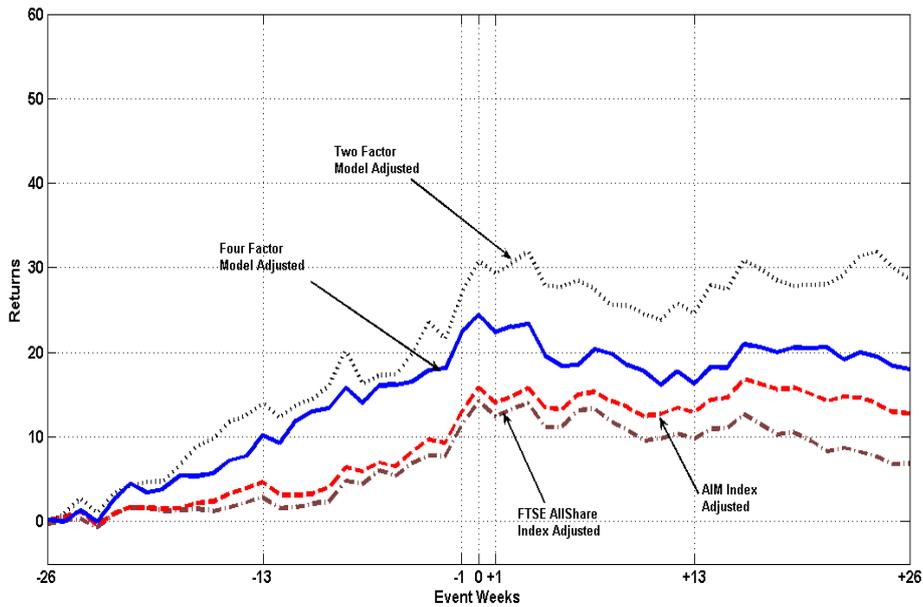
**Figure 3**  
**Cumulative Abnormal Returns: Up Switchers**

Panel A (B) of this figure plots cumulative abnormal returns for the firms switching from AIM to Main in our sample around the announcement (switch) dates. The CARs are constructed four different models: the four-factor model; a two-factor model comprising the FTSE All Share and AIM indices; and simple market adjustment using the FTSE All Share and the AIM indices.

**Panel A: Announcement Date**



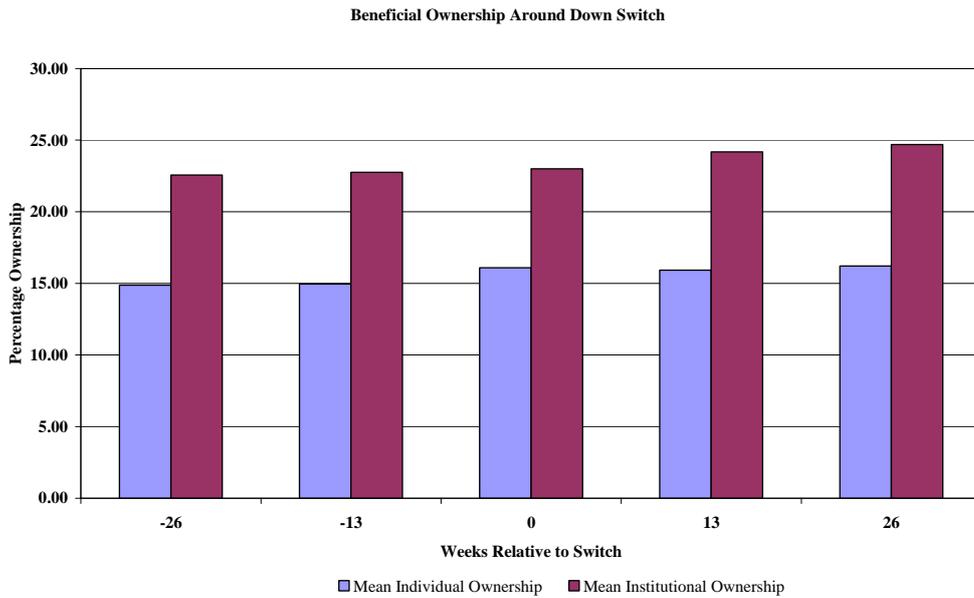
**Panel B: Switch Date**



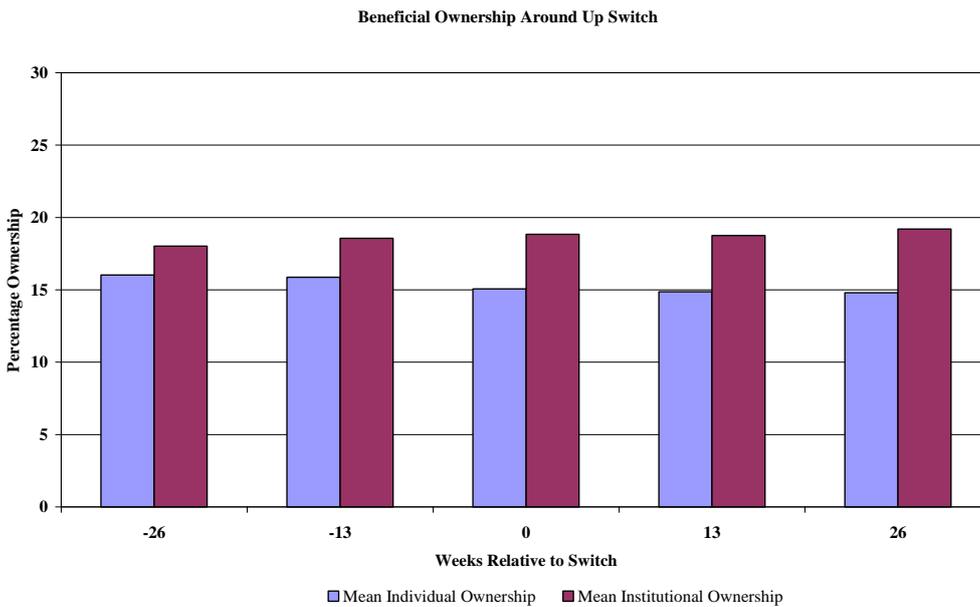
**Figure 4**  
**Beneficial Ownership Around the Switch**

Panel A (B) of this figure plots the average ownership of all external beneficial owners (those owning >3% of the firm), as well as the ownership by all directors of the firm in Down (Up) switchers in the [-26,+26] week window surrounding the switch. These data come from the Extrahold/Hemscott Database. The ownership statistics are reported separately for individuals and institutional owners.

**Panel A: Down Switchers**



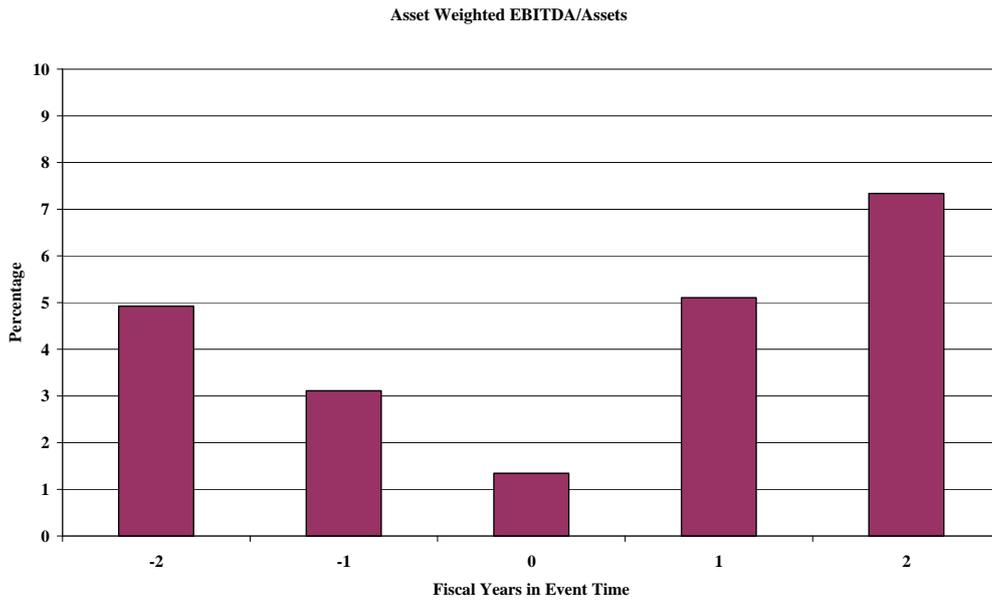
**Panel B: Up Switchers**



**Figure 5**  
**Operating Performance Around the Switch**

Panel A (B) of this figure plots the asset-weighted EBITDA/Total Assets of all Down (Up) switchers in the [-2,+2] fiscal year window surrounding the switch. Year 0 is the last full fiscal year prior to the switch. These data are the same as in Table VI, which presents details about their construction, and the sample.

**Panel A: Down Switchers**



**Panel B: Up Switchers**

