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Title

*The Impact of New Change in the Rules on the
Small and Medium Size Enterprises Listed in
Alternative Investment Market of the UK*

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INTRODUCTION

Corporate Governance (CG) is a mechanism that improves the competitive advantage and efficiency of the firm. This concept is highly applicable to large companies (premium listing companies), especially in the UK. Although small and medium-sized enterprises (SMEs) are a great source of economic development (Lukács, 2005), still nominal evidence has been found in the previous literature about the application of corporate governance codes on the SMEs listed in Alternative Investment Market (AIM) in London Stock Exchange (LSE).

However, LSE recognized the increasing significance placed on the smaller quoted companies to adhere to good corporate governance practices and because of this, LSE updated the rules of AIM companies. Under AIM rule 26, LSE made it compulsory for the AIM-listed companies to comply with the recognized CG code and voluntarily disclosed the details of it on the corporate website to bring transparency for the investors (Nel and Baard, 2019). The purpose of this study is to identify how well the SMEs adhere to the new legislation; the impact of a new change in governance on the financial performance of the companies by testing the hypothesis; and provide recommendations to SMEs to enhance their financial performance.

BACKGROUND OF THE STUDY

The concept of corporate governance has gained immense practical significance due to the high-profile mismanagement of big and multi-national private enterprises (Shleifer and Vishny, 1997). As per the theorists who stand up for agency theory, corporate governance is an organized outline of some amount of control over the activities of agents of the firm such as managers (Marie L'Huillier, 2014). Undoubtedly, agency theorists played a vital role in developing the framework of corporate governance. However, there are several other

academic writers, who do not adhere to agency theory and write about corporate governance using other theoretical viewpoints such as stakeholder theory and resource dependency theory.

ROLE OF SMEs LISTED IN THE UK

This study is specifically focusing on the application of corporate governance in SMEs listed in the UK. It is highly essential to pay concentration towards SMEs as in the UK SMEs employ 16.6 million individuals. In addition to this SMEs contribute 52% of the overall economy's turnover and 54% of the total economic output. Nowadays, it is becoming more and more important to support SMEs to protect and enhance the economy of the UK (Santander, 2018). Despite the major contribution usually made by the SMEs, their growth and the potential survival are affected due to the limited access to external finance. Therefore, to resolve the problem of SMEs to some extent LSE create a sub-market known as Alternative Investment Market (AIM) which specifically create opportunities for SMEs to register and get access to public funds (London Stock Exchange, 2018). In addition to this, SMEs can enter the market by fulfilling minimal entering and disclosure requirements.

AIM RULE 26

Before 2018, SMEs listed in AIM were not essentially bound to follow the UK CG code whereas there is a compulsion for the premium listed companies to adhere to the UK CG code (Abor & Adjasi, 2007; Cronin and Murphy, 2012). However, recently in 2018 LSE amended the rules of AIM companies regarding the disclosure regulations. According to the recent amendments in AIM rule 26, all the AIM-listed companies should follow a recognised CG Code as per the nature and size of their firms (The Quoted Companies Alliance, 2018b). Additionally, companies will be required to disclose the details of CG code that has been applied on their website and need to review it annually. This amendment has been

particularly done to bring more transparency between the affairs of the companies listed in AIM and investors (Harber and Zulafqar, 2018). Moreover, by complying with the suitable CG code SMEs may be able to win the confidence of the investors which ultimately help them to get access to external finance. Further this abstract explores the AIM rule 26 and its impact on SMEs.

CORPORATE GOVERNANCE CODES FOR SMEs

Generally, SMEs do not have many options in terms of CG codes to select one. Similarly, it is evident from the previous literature that mainly two codes are highlighted as benchmarks for SMEs listed in AIM: the UK Corporate Governance Code (UKCGC); and the Quoted Companies Alliance Code (QCA Code) (Burgess Salmon, 2018). The premium listed companies follow UKCGC which is also considered as the apex of corporate governance, but due to different size, requirements and development stage of SMEs, many small and mid-size AIM-quoted companies may select the QCA code as a more appropriate code (Harber and Zulafqar, 2018). In the updated versions, the focus of both the codes remains the same on engagement between the company, shareholders and their stakeholders, demonstrating a commitment towards good corporate governance with 18 principles and 41 provisions in UKCGC and 10 broad principles in QCA. This also justifies the reason for selecting QCA code by 400 SMEs out of more than 900 SMEs listed in AIM (The Quoted Companies Alliance, 2018b).

RESEARCH APPROACH

The general question in research, should the research start with the theory or the theory itself come up as a result of the research? Therefore, Gray (2013), states criteria that establish the scientific approach, involving: inductive discovery and deductive proof. However, to

achieve the objectives, the deduction approach goes well with this study as it commences with the common glimpse of the situation and works back to the peculiar result.

Further, in the matter of data collection methods, secondary data will use. The variables of corporate governance, data will gather from accurate and reliable databases and companies websites or annual reports and for financial variables, data will gather from databases but to make it suitable for the research, some formulas or calculations will be done specifically for this study. Additionally, Gretl software will use to run the tests for the analysis and finally for the results.

CONCLUSION

The planned study aims to identify the application of CG code by SMEs and test several hypotheses, to investigate the association between CG variables and financial performance of the companies listed in FTSE- AIM which are basically, small and medium-sized enterprises (Afrifa and Taurigana, 2015). This explanatory study will be the first study as per the knowledge of the author which examines the impact of a new change in legislation on listed SMEs. More significantly, this study examined the relationship between principles of QCA code and corporate performance variables of UK-listed SME's in the Alternative Investment Market.

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