SPEECH BY PROFESSOR JUANITA GONZÁLEZ-URIBE

Your Majesty, Minister, Honoured Guests, Chairman and Members of the Jury, members of the Fernández de Araoz family, Luisa, guests and friends, good evening.

I speak to you as the co-author, with Daniel Paravisini, who is also with us today, of the winning paper in the seventh edition of the Jaime Fernández de Araoz Award.

I should like to begin by thanking a number of people. Thank you Your Majesty for your support for this initiative, and to the Fernández de Araoz family for your vision and generosity in creating this Award. I would like you to know that it is an honour for us to have been accorded this recognition and to be here with you in Madrid today.

I should also like to thank my extended family: My co-author, Daniel, and his wife, Veronica, who is also with us today, for sharing their knowledge, their experience and their friendship. My parents Jaime and Sandra, who are here, and my sister Catalina and her family, I thank you for your unconditional support throughout all these years. Finally to my husband, Daniel Perdomo, who is also here with us, I thank you for being my endless source of joy. I feel very fortunate to have this wonderful group of people in my life.

I will now tell you a little about the research work that is being honoured today for its contribution to corporate finance.

The main theme of this research is the development of young companies. This is an important subject, because young companies are the main driving force for overall growth. In England for
example, despite being small in size, these companies account for 40% of total annual investment.

The specific issue researched was the effect that subsidies on the issue of shares to third parties had on the development of young companies. Broadly speaking, companies have two sources of outside financing: the contracting of debt and the issue of shares to third parties, that is to say shares that are issued to people other than the company’s owners.

The basis for our research was a subsidy that was introduced by the British government in 2013. The aim of this subsidy was to reduce the cost of issuing shares to third parties, which was perceived as being too high. This subsidy offered tax benefits to individual investors in young companies, including income tax deductions on 50% of the capital invested.

Three main results emerged from this research. Firstly, a very small percentage of young companies made use of this subsidy. In particular, only 1% of eligible companies issued shares to third parties. The second result was that for this 1% of companies that made use of the subsidy, investment increased dramatically. For each pound sterling issued in third party shares, the companies invested 7 pounds more. The third main result is that this additional investment was financed with debt - debt that was in some cases issued to the same investors who bought the new shares.

What does our research teach us about economic policy? What have we learned? The first finding is that the government’s perception is correct: the cost to young businesses of issuing shares to third parties is quite high. If it were not, more companies would have made use of the subsidy.

The second finding explains the nature of these costs involved in the issue of shares to third
parties. Broadly speaking there are two types of costs. The first are transaction costs: issuing shares means taking on lawyers and drafting contracts. The second type of cost is more complex and arises from information difficulties between the owners of the young business and potential investors. For example, the owners of young companies frequently prefer to take on debt instead of issuing shares to third parties, as they worry that by issuing shares they will lose control over their company, once the new investors become part of their business. Our results suggested that the majority of costs fell into this second category: information problems between owners and investors.

I should like to end this presentation of our work with a reflection that draws a parallel between the British subsidy for research and Silicon Valley in the USA, the most successful example of an entrepreneurial ecosystem in terms of business development.

One of the main characteristics of Silicon Valley is that the issue of shares to third parties is a principal source of financing for the young companies operating there. It is partly due to this phenomenon that governments like Britain’s subsidise this kind of financing source.

The reflection that I would like to leave you with is in two parts.

The first is similar to the well-known puzzle of the chicken and the egg. Governments cannot necessarily replicate the success of Silicon Valley by subsidising the issue of shares to third parties. In cases like Silicon Valley, it is difficult to know whether the development of its young companies was due to the issue of shares or, by contrast, to their high potential for development. Hence the problem of the chicken or the egg. Which came first? The issue of shares? Or the development of the business? One very important contribution made by our research was demonstrating that for a
small percentage of young companies in England, the issue of shares resulted in development. Our results showed that public policy can indeed affect the development of entrepreneurial ecosystems.

The second part of my reflection is what I will call the case study fallacy. When looking at our results, it is tempting to conclude that this subsidy is not effective. We found that only 1% of young businesses issued shares to third parties, while in ecosystems like Silicon Valley the figure was close to 100%. Hence the case study fallacy. The problem with reaching such a conclusion is that it overlooks the fact that Silicon Valley is not the whole of the United States. In fact, statistics for the US suggest that only 1% of the total number of young companies issue shares to third parties. Not all young companies have either the potential or the desire to be the next Google. The message here is that measuring the success of a policy for a group of businesses against a case study is misleading and could lead one to the wrong conclusions.

I would like to end as I began. Thanking Your Majesty for your support and the Fernández de Araoz family for your vision and generosity. My grateful thanks to everyone here for your attention and time, and for informing people of the results of our research through the media.

Many thanks!