QUOTED COMPANIES ALLIANCE

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Business, Energy and Industrial Strategy Committee
House of Commons
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Dear Sirs,

From start-up to scale-up: support for growing businesses

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

We welcome the opportunity to respond to the Business, Energy and Industrial Strategy Committee's inquiry on business scale-ups. In an uncertain economic environment identifying and supporting potential high-growth companies – wherever they are located in the UK – will play a key role in generating sustainable economic growth and stimulating job creation.

Despite the challenges facing the UK in the coming years, the QCA sees an opportunity in reshaping the current market structure by recalibrating the regulatory and tax framework, so that high-growth companies are better supported and are able to gain access to the long-term investment that will enable them to thrive.

To best support growth companies in the years ahead, we call for:

1. **Costs of raising equity to be tax deductible**. This will give companies a greater incentive to raise finance on public markets and promote long-term economic stability;

2. **Broadening the scope of Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) rules** to enable growing companies of all ages to raise the finance they need to flourish;

3. **Relaxing Company Share Option Plan (CSOP) requirements** to incentivise the provision of long-term finance and encourage employee share ownership;

4. **A review of the prospectus rules** to suit the needs of UK capital markets once the UK has left the EU; and

5. Finding **alternative vehicles for public company investment** and challenging the current **"one share, one vote"** model**.**

The Quoted Companies Alliance is the independent membership organisation that
champions the interests of small to mid-size quoted companies.

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Responses to specific questions

Q1 How effective have recent Government measures been in supporting scale-ups in the UK? What has been the impact of the Coutu review in overcoming barriers to scale-ups, particularly relating to accessing skilled talent, developing leadership and financing scale-ups?

The Government has taken some positive steps in supporting UK scale-ups. We welcomed the decision to allow investors to include small and mid-size quoted company equities in their ISAs. Enabling investment returns from these companies' shares to be exempt from income and capital gains taxes has incentivised and facilitated further investment into smaller, growth companies. Similarly, abolishing stamp duty on the trading of growth market shares, such as those on AIM and NEX Exchange, has stimulated liquidity and enabled small and mid-size quoted companies to finance their growth at a cheaper cost.

These measures have helped support UK scale-ups by promoting the use of public equity markets as an affordable and accessible path for growth companies to raise funds.

We also welcomed the Government's decision to extend Capital Gains Tax Entrepreneurs' Relief to external investors in unlisted trading companies for newly issued shares. While it is too soon to appraise the impact of this policy, we expect this measure to encourage more investors to take on the higher risk associated with supporting smaller companies on growth markets, such as AIM.

Q2 What more needs to be done to improve management and business skills necessary to support scale-ups? What are the barriers here?

Good corporate governance enables companies to reduce risks as they grow and develop. Effectively embedding appropriate processes and values into the organisation helps inspire trust from investors, which in turn reduces the cost of capital. Good corporate governance also acts as a powerful tool in supporting a company's growth strategy. Successfully grasping the principles of good corporate governance practice will lead to better management and business practices.

A significant barrier to improving corporate governance practices is a lack of awareness among companies of existing governance guidance. Company directors should be aware of corporate governance codes appropriate for their company's needs and the Government should play a leading role in highlighting guidance that is tailored to the needs of growth companies.

The QCA Corporate Governance Code for Small and Mid-Size Quoted Companies (the QCA Code) has become a valuable reference for smaller companies wishing to follow good governance practice, regardless of whether they are listed on a public market. It advocates a practical, outcome-oriented approach to corporate governance for companies not obliged to apply the FRC's UK Corporate Governance Code. Although primarily targeted at quoted companies, it is specifically designed to enable companies at different stages of development and of different sizes to adopt good corporate governance practice.

Q3 How accessible and joined-up is business support, for example between LEPs, Growth Hubs, the banks and others?

We have no comments.

Q4 What data should be collected and made available to better identify potential scale-ups, including businesses led by women?

We have no comments.

Q5 What steps should the Government take, if any, to improve and incentivise the provision of patient capital? What distribution mechanisms are in place to ensure that businesses throughout the UK can access this capital?

Over the years, the QCA has worked on a number of initiatives to improve and incentivise the provision of long-term capital. We have outlined proposals below which we believe would contribute to cutting down barriers to patient capital.

I. Level the playing field between equity and debt

There is a distinct need to address the preferential treatment of debt over equity as a source of finance for growing companies. Currently, companies can claim a tax deduction for costs incurred in raising debt finance, but not for equity finance. This has resulted in a distorted tax system.

Yet, OECD research has highlighted the advantages equity has over debt: "The empirical results reported above suggest that in most OECD countries more debt is typically associated with slower growth while more stock market financing generates a positive growth effect. Furthermore, recent OECD work[1] (Ahrend and Goujard, 2012) found that corporate tax systems which favour debt over equity are associated with a higher share of debt in external financing, thereby increasing financial crisis risks. The economic literature and earlier OECD work identified that the debt bias in corporate taxation generates costly economic distortions (De Mooij, 2012; Devereux et al., 2013; OECD, 2007). These findings all underline the growth benefits of reducing the debt bias in corporate taxation. Effective average tax rates on equity finance generally exceed those on debt finance, primarily because interest expenses are cost-deductible."[2]

Similarly, a review of the European listings regime has indicated that allowing equity costs to be tax deductible would promote long-term stability and help smaller companies secure long-term capital to sustain their growth.

The Government should level the playing field between debt and equity by providing tax relief on all costs relating to the issue of new shares as part of a public offering (both IPO and secondary fundraisings). Enabling smaller, growth companies to fully harness the potential of capital markets would widen the provision of long-term capital and establish a sustainable funding pipeline for growth companies.

We have set out in detail how such a relief could be implemented in our Proposals for Taxation Reform[3] for the 2017 Budget; this would be an inexpensive way to improve the provision of patient capital.

[1] http://www.oecd-ilibrary.org/economics/drivers-of-systemic-banking-crises_5kg3k8ksgglw-en?crawler=true
[2] Cournède, B., O. Denk and P. Hoeller (2015), "Finance and Inclusive Growth", *OECD Economic Policy Papers*, No. 14, OECD Publishing, Paris
[3] Quoted Companies Alliance Proposals for Taxation Reform – 2017 Budget:
http://www.theqca.com/article_assets/articledir_253/126681/QCA%202017%20Budget%20Representations_Working%20Document%20-%20FINAL_Jan17.pdf

II. Broaden the scope of Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) rules

Creating a tax system that encourages long-term investment by potential high-growth companies is essential in increasing the number of successful high-growth businesses in the private sector. We believe that the Government should broaden the scope of EIS and VCT rules, so that all growing companies, regardless of their age, can fully leverage these venture capital schemes. This would allow more high-growth businesses to raise the finance they need to flourish. We have seen examples of smaller quoted growth companies that have sought investment, only to find they are ineligible to take advantage of EIS and VCT, due to the time limits imposed.

Some conditions specified in the EIS/VCT rules can also be very difficult for small and mid-size quoted companies to meet – particularly those regarding new products, geographical markets and skilled employees. Refining these requirements would add more clarity and alleviate administrative burdens for growth companies.

Equally, the new rules have placed an additional burden on many advance assurance applications, which has led to increased waiting time for responses. This in turn has placed further constraints on companies seeking to raise financing for their businesses. The Government should increase the Small Companies Enterprise Centre's resources to reduce complexity and bring down timescales, to enable the service to allow small, growing companies to take full advantage of these venture capital schemes.

III. Relax Company Share Option Plan (CSOP) requirements

The current CSOP legislation does not meet modern remuneration practices. The administrative burdens deter many smaller companies from offering such an arrangement. The Government should introduce more flexibility for CSOPs by allowing the exercise price to be at a discount or at nil cost, removing the three year holding period before options can be exercised with income tax relief and introducing a rolling £30,000 limit for all existing options. Implementing these measures would incentivise the provision of long-term finance and encourage employee share ownership.

IV. Revise the prospectus rules to suit the needs of UK capital markets as soon as possible after the UK has left the European Union

We have welcomed many aspects of the revised prospectus rules and believe they represent an improvement on the current regime. Nonetheless, following the UK's departure from the European Union the Government should make further adjustments to the rules, so that the regime is more appropriate for the needs of the UK's capital markets. Raising the threshold for which companies are obliged to produce a prospectus to at least £20m, deleting the page limits for prospectus summaries and removing the restrictions on the number or type of risk factors that can be included in the prospectus or in the prospectus summary would be welcome first steps in encouraging smaller, growth companies to seek funding from public capital markets.

V. Explore alternative vehicles for public company investment

The Government should look to challenge the "one share, one vote" model of corporate ownership. Many entrepreneurs are often reluctant to "give up control too early" when they join a public market. One potential solution could be to allow new IPO companies with suitable stakeholder representation to list variable voting shares on the stock market, subject to them following an appropriate corporate governance

code. This could encourage entrepreneurs to enlist their company on a public market by enabling them to maintain control of the company they have founded, and also open new opportunities for them to attract new sources of long-term capital that can then be used to grow the company.

The Swedish experience – where 40% of all companies on the Swedish stock market, including the growth market First North, have some form of variable voting right structure – suggests that such ownership models do not deter investors from investing in such companies. Swedish markets saw 88 IPOs in 2016, compared to 114 on the London Stock Exchange's markets.

Similarly, the recent successes of Google and Facebook should encourage the Government to explore alternative vehicles for public company investment. Their experience indicates that investors are not necessarily deterred from investing in companies that have variable voting rights.

Q6 Are there other regulatory or economic interventions that the Government should make to achieve the objective of increasing the number of successful and high-growth businesses in the private sector?

As a general comment, we strongly encourage the Government to prioritise the needs of smaller companies when considering any new policy instruments. Measures deemed suitable for the largest companies are often ill-suited for small, growing companies and put disproportionate requirements on these companies creating unnecessary barriers to growth.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive