QUOTED COMPANIES ALLIANCE

Research Report

State of the Small and Mid-cap Sector

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About This Report

The QCA's *State of the Small and Mid-cap Sector* report is being published following the Chancellor's recent 'State of the Sector' Report to the House of Commons. As its name suggests and, in contrast to the Chancellor's Report, this Report is focussed on the UK public markets as they apply to small and mid-cap companies. These companies together make up 91 per cent. of all listed companies and employ over 2.1 million people. They are also capable of driving dynamic innovation and rapid growth. Therefore, if the UK capital markets are to prosper and grow, they need to cater for and be attractive to this sector. In this report we will look at why the markets are failing this critically important community, what steps are being taken to 'fix' the problems and what further steps should, in our view, be taken in this regard.

This report consists of four parts:

- a quantitative analysis of the state of the UK's primary and secondary markets and a look at the social benefits of public equity;
- a qualitative examination of the key issues relevant to companies, investors and other stakeholders;
- a broad summary of the key regulatory changes and developments within the sector and our commentary on those changes and developments; and
- our suggestions for the further improvement and enhancement of our public markets to attract small and mid-cap companies.

Section 1 and **Section 2** summarise the landscape in which small and mid-cap companies are operating and clearly illustrate the need for reform which was the central theme of the Listing Review which Lord Hill led in 2021.

Section 3 and **Section 4** are in narrative form and provide our commentary on the reforms which are currently under consideration and, equally importantly, our views as to the further steps that need to be taken to reverse the current decline.

Quite simply, this report provides evidence of the need for structural change both on the demand and supply side across the UK's public markets, and in the small and mid-cap space in particular. The question that we all need to address is, "how can we attract and retain tomorrow's innovative leaders when our markets fail to deliver wholehearted promotion and dynamic innovation themselves?"

We do not have all the answers. However, we hope that this report will be broadly read and that its recommendations will form the basis for serious consideration by our legislators, regulators and market operators with whom we are actively engaged in our mission to create an environment where small and mid-sized companies can grow and deliver sustainable long-term benefits for investors and wider society.

QUOTED COMPANIES ALLIANCE

Adam McConkey
Chair, QCA

A holistic approach to reform – taking into account demand and supply-side factors – is essential

Introduction from Adam McConkey, Chair, QCA

Public markets are great. They have contributed to and are responsible for repeated success stories for companies and investors throughout the world, both large and small.

As we have highlighted in this report, our markets – and the small and mid-sized quoted companies that operate on them – have an enormous, positive impact on the economy and society. Small and mid-caps represent the vast majority of quoted companies, and their significance in terms of employing UK citizens (both nationally and regionally), job creation and tax take should be celebrated. They also contribute to the levelling up agenda by reversing the income and growth disparities within the UK.

The importance of our markets during times of crises and adverse conditions is largely ignored. This was most recently demonstrated during the Covid-19 pandemic; astonishing levels of adaptability and resilience were witnessed during this period that, arguably, helped bring us out of the pandemic. The ability of the public markets to provide liquidity and finance during extreme circumstances meant that very few companies foundered and most employees were able to keep their jobs.

Yet, we find ourselves in a depressing situation: the UK's markets are dwindling. The significant outpouring of companies in the last twenty years is matched by a desperately concerning outflow of funds. A holistic approach to reform – taking into account demand and supply-side factors – is essential. Our markets must incentivise both companies and investors towards their greater use. Addressing structural inefficiencies, enhancing the ability of companies to raise money and reducing costs and burdens will improve the attractiveness of our markets to companies and encourage them to join. This must then be matched with incentivising investors to release longer-term, structural capital into the markets.

All of this should be underpinned by incorporating the principle of proportionality into any developments. Small and mid-caps are the majority, they are the engines of growth, and they should be the priority. Equity markets can only deliver on producing their associated public good benefits when they are placed at the centre of policy and resulting action. It cannot be stressed enough how important a joined-up, proportionate approach will be to correcting our markets.

Change is needed and it is needed now. We must strive to enable our markets to grow again.

Adam McConkey
Chair, QCA

QUOTED COMPANIES ALLIANCE

Tim Ward
Chief Executive, QCA

If small and mid-caps are treated as an after-thought, incidental to the louder voice and needs of the large players, we will not see real change in our markets

Introduction from Tim Ward, Chief Executive, QCA

In its simplest form, the purpose of a public market is to provide a venue for companies and investors to come together in order to create wealth and opportunity. Public markets allow investors to participate in the success of a company as it raises funds and elevates its profile to scale up and grow.

However, public equity markets are so much more than this; they are a social good. They foster entrepreneurialism, create intellectual property, encourage product disruption and innovation, generate jobs, distribute wealth across society and, ultimately, produce economic growth. All of this occurs within a more open, accessible, and transparent environment than any other means can offer. Private equity, for instance, is exclusive, being only open to certain types of investor.

The responsibility of maintaining the economic and social value of the public markets falls on all of us, but it is Government, regulators and market operators that must take concerted action to ensure a culture and environment that is conducive to maximising the virtues of our public equity markets. Fostering a broader long-term culture in public markets and redressing the regulatory imbalance between public and private equity will have the greatest influence in enacting behavioural change and encouraging deeper and more liquid public markets. This can be fulfilled, in part, through the provision of choice by inspiring companies at an earlier stage of their growth to list, allowing investors to gain access to the higher levels of growth that can occur.

The QCA's *State of the Small and Mid-cap Sector* report delves into the make-up of the UK's public equity markets to disclose their current state so that we can develop a deeper understanding of our markets and what we can do to improve their effectiveness, to the benefit of all. The report covers the London Stock Exchange's Main Market and AIM and the Aquis Stock Exchange (AQSE).

The Capital Markets Industry Taskforce is a very welcome initiative, announced at the same time as the publication of the Government's *State of the Sector* report. However, if small and mid-caps are treated as an after-thought, incidental to the louder voice and needs of the large players, we will not see real change in our markets.

This report demonstrates very clearly that the engines of growth need to be the subject of the first paragraph for all market initiatives and not merely reduced (as ever) to a footnote.

Tim Ward
Chief Executive, QCA

Executive Summary

The findings from each section of this report can be grouped thematically into key issues/areas.

Section 1: Quantitative Data

The social and economic benefits produced by the small and mid-sized quoted company community

Small and mid-caps:

- Represent 91% of all companies quoted on the LSE, highlighting their enormous significance and relevance to our markets;
- Have a collective market capitalisation of £376 billion by equity market value;
- Employ over 2.1 million workers;
- Account for more than 75 per cent. of the workforce of all quoted companies across the regions of the UK; and
- Contributed at least £25.1 billion in taxes in 2020/21.

The current de-equitisation trends on UK public markets

- The number of companies on our markets has declined considerably in the last 20 years (-36% in total). The Main Market has decreased by 50% since 2001, and since its peak in 2007, AIM has decreased by 49%.
- The average annual number of IPOs has slightly decreased in the last twenty years. However, viewing the IPO market in isolation is illusory, with the number of de-listings consistently outpacing the number of IPOs between 2009-2021.
- The average size of companies on the UK's public markets has increased significantly over the last twenty-year period, indicating that smaller companies are not joining/leaving the markets, and private companies are opting to join the markets at a much later stage in their growth.

The nature of the companies on the UK's public markets

- The vast majority of companies that operate on the UK's exchanges are not 'large', but smaller, growth companies. The true relevance of the UK small-cap universe as part of UK quoted exchanges should not be underestimated and must be understood by Government and the regulators.
- Nearly 4 in 5 companies have a market capitalisation below £1 billion, which is considered by most definitions to be small-cap.
- Over a quarter of companies have a market capitalisation under £25 million.
- Whilst Main Market companies have a larger total market share, many of the companies are small and mid-sized quoted companies (52% of companies with a market cap below £1 billion are on AIM and 48% are on the Main Market (see page 17 for illustration)).

Section 2 – Attitudes and Sentiment

Company and investor attitudes

- The attractiveness of public markets for small and mid-caps is perceived differently by companies and investors, with investors typically seeing the market as more attractive than companies. Only 3 in 10 companies think that the market has improved in attractiveness in the last year, whereas 5 in 10 investors think it has improved.
- While there is a general disconnect in the perception of the value of public markets by companies and investors, what is of greater concern is how expectations by both constituents has been devalued over time. This is a dangerous and concerning trend.
- Companies and investors typically believe that the quality of corporate governance has not improved in the last 12 months. Investors have a more positive attitude than companies towards the impact that ESG funds will have on the attractiveness of the markets.
- The perceived importance of retail investors is growing; a significant majority of companies and a majority of investors believe that having retail investors on the share register is desirable.
- A majority of both companies and investors do not believe that the quantity and quality of research produced on small and mid-caps is sufficient.

Company and advisory firm sentiment

- Confidence in the UK economy has slipped significantly in the last 12 months, with the balance of companies now more pessimistic than they are optimistic.
- However, despite decreasing in the last 12 months, confidence for business prospects remains optimistic overall.
- There is a good level of optimism for companies both in terms of job growth and turnover expectations.
- Over 40% of companies plan to raise capital within the next 12-month period, with public equity, rather than bank debt, being the preferred choice of finance.

Section 3 – Regulatory Reform, Change and Developments

The overall speed and efficiency demonstrated by Government and regulators regarding the reform agenda since the conclusion of the Listing Review in 2021 has been highly positive. Similarly, the general direction of travel has been promising too. Despite some developments to the contrary – most notably the BEIS proposals on audit and corporate governance reform – there appears to be a genuine desire amongst Government and regulators to make our markets more attractive and fit for the future. There is, for the first time in a long time, alignment between policymakers and market participants, including companies, investors and intermediaries; this is rare, and should not be taken for granted.

The UK Prospectus Regime Review, Wholesale Markets Review, UK Secondary Capital Raising Review, Future Regulatory Framework Review, Primary Markets Effectiveness Review, and the amendments to UK MiFID have significant potential to create positive change to our markets. It is important, given there are many reviews being performed by many different bodies, that the decision-making process is nimble enough to implement proper change and positive reform. There is a danger that the layering of responsibility adds to the complexity and time being taken to achieve true change.

In addition, we must ensure that these initiatives, focusing on supply-side issues, are coupled with initiatives and reforms that have a focus on the demand-side. Without reversing the outflow of funds from our public markets, the situation cannot improve.

Section 4 – Solutions

Supply-side solutions

We propose several supply-side solutions aimed at increasing the attractiveness of our markets to ensure a healthy and plentiful supply of companies coming to, and staying on, our markets. This includes:

- Establishing a new UK Listed Growth Market
- Enhancing secondary capital raising
- Prospectus reform

Demand-side solutions

We have put forward several demand-side solutions aimed at incentivising and encouraging the release of longer-term, structural capital from a range of investors to halt the outflow of funds from our public markets. This includes:

- Reforming Solvency II
- Reforming pension fund investment
- Enhancing liquidity
- Increasing the quality and quantity of research

Proportionality

As an overarching solution, we must ensure that the principle of proportionality is embodied throughout the market ecosystem. To ensure the effective functioning of our markets and their future success, a proportionate approach to any legislative or regulatory developments is absolutely essential.

A new approach to reform and the civil service and regulators

We propose two key changes to the make up of the civil service and the regulators, including:

- an independent, overarching figure to be appointed to have responsibility for the overall vision and direction of travel of regulatory reform; and
- the civil service and regulators to be required to appoint, on secondment or otherwise, market participants and industry figures to help guide their work.

We urge the Government and regulators to take heed of the deeply concerning trends highlighted in this report by engaging further on the solutions we propose.

Now is the time to drive through real change so that our markets can thrive in the future, helping to ensure that we continue to celebrate the positive social and economic impact of our markets.

1

1: Quantitative Data

This section features the key statistics that make up our markets, including the London Stock Exchange's Main Market and AIM, and the Aquis Stock Exchange (where data is available).

NOTE: All data used within Section 1 of this Report derives from the data provided on the London Stock Exchange's website[1] or the Aquis Stock Exchange's website[2] unless specified in the footnotes. The data for AQSE is not available for all the areas covered in this Section.

1.1 The social benefit of public equity markets

This section of the QCA's *State of the Sector* report focuses on a report published in May 2022 by the QCA, in conjunction with Hardman & Co, on the value of small and mid-sized quoted companies[3].

Market contribution

On the last day of trading in May 2022, there were 1,957 companies quoted on the Main Market and AIM. After filtering out investment companies and international companies whose London quote is a secondary one, there are 1,180 companies; 476 of which are on the Main Market and 704 on AIM.

The key findings in terms of market contribution include:

- 91% of companies on these markets are small and mid-caps;
- The largest 100 companies account for 85% of total market capitalisation;
- The other 1,080 small and mid-caps account for 15% of total market capitalisation;
- Small and mid-caps have a collective market capitalisation of £376 billion.

Figure 1 shows all the companies quoted on the London Stock Exchange's Main Market and AIM by market capitalisation. It illustrates the huge disparities in size between the 100 largest companies and the remaining 1,080 small and mid-sized quoted companies.

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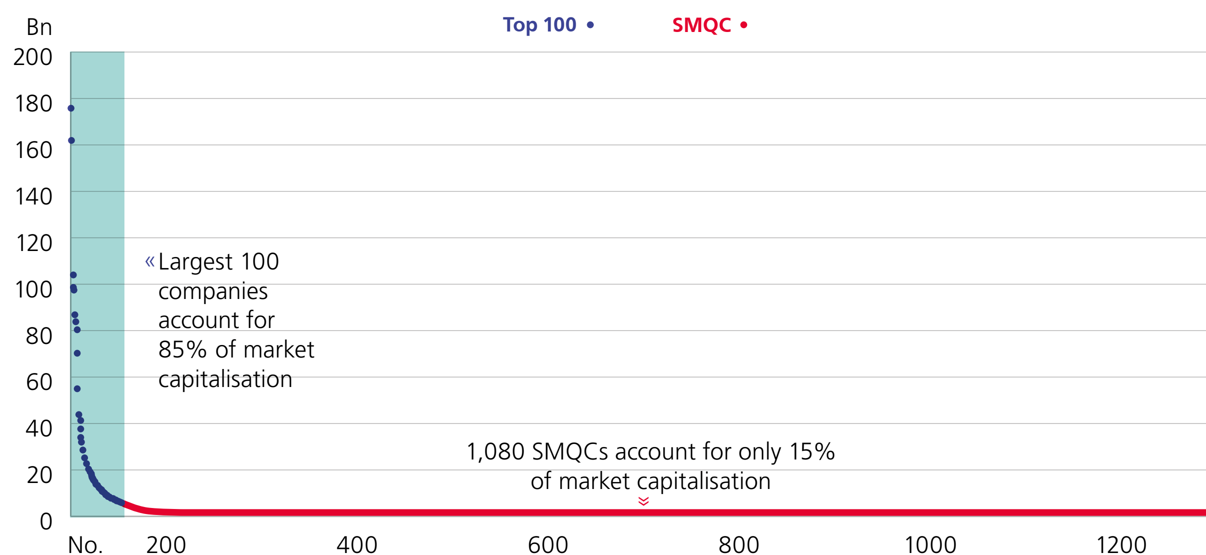
1 London Stock Exchange website, News and Prices, Reports, available at: https://bit.ly/3MkI14d
2 Aquis Stock Exchange website, available at: https://www.aquis.eu/
3 QCA/Hardman & Co, July 2022, Punching above their weight? The contribution of small and mid-cap quoted companies to markets, employment and tax revenues, available at: https://bit.ly/3ywBldx

There is a misjudged consensus in the financial world whereby investment universes are defined in absolute capital terms. Given the giant quantum of the mainstream UK quoted companies, it means UK small-caps are automatically viewed as being a relatively minor part of the UK markets. This is categorically not the case. The graph, quite dramatically, shows how there are very few companies of a significant size. There are very few companies in the investment universe with a market capitalisation over £3 billion, a small number of companies between £3 billion and £1 billion, slightly larger numbers between £1 billion and £0.5 billion, and a huge amount of companies below £0.5 billion.

When the scale of UK small-caps is recognised in this context, it is obvious that the appropriateness of any proposed policy changes can only be properly assessed after giving considerable weight to their needs given their position as the source of the mainstream stocks of the future.

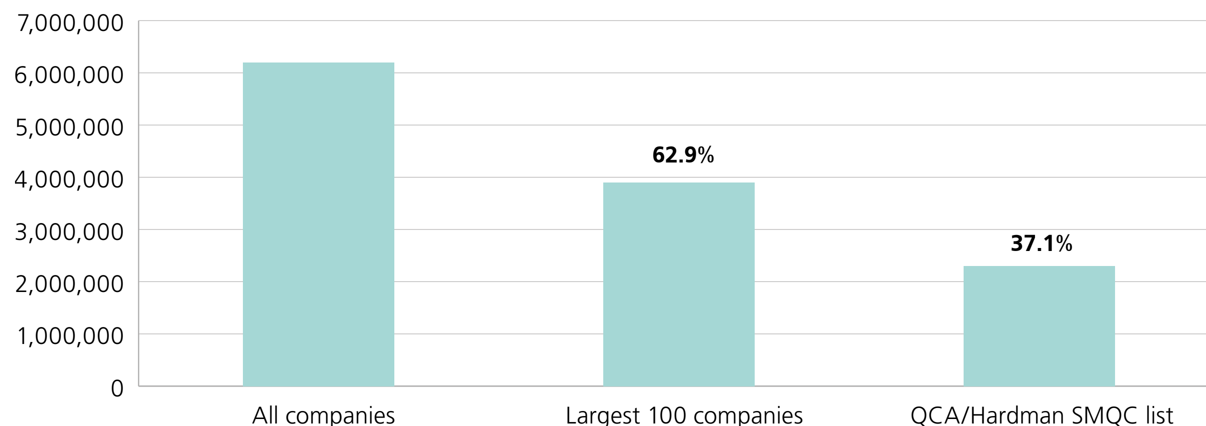
Figure 1 – Companies by market capitalisation



Employment and job creation

Data for employment was collected for financial years ending during 2021 and is shown in Figure 2.

Figure 2 – Number of employees by quoted company universe



The key figures include:

- In total, quoted companies employ just over 6.1 million people.
- The largest 100 companies employ 62.9% of these people.

Small and mid-sized quoted companies employ over 2.1 million people, representing 37.1%. Moreover, small and mid-sized quoted companies have a very important impact in light of the levelling up agenda. Of the 2.1 million people employed by small and mid-sized quoted companies, over 1.1 million (or nearly 53%) of these people are employed outside of London in the UK's nations and regions. In addition, they account for more than 75% of the workforce of all quoted companies across the regions of the UK.

The largest 100 companies meanwhile account for nearly 63% of the jobs provided by the public market as a whole. It should be noted that the FTSE 100 is dominated by particularly mature industries and companies who are reacting to the changing structures of the global and domestic economy. No longer buoyed by the relentless march of globalisation with legacy and models and supply chains challenged by the march of technology and compulsion of sustainability, these companies are typically in a defensive, not disruptive mode, at best maintaining employment rather than expanding job opportunities, creating, developing and expanding intellectual property and the communities in which they operate.

Since we last produced the report in 2019[4], there has been a net loss of 169 companies (426 left the markets with 257 companies joining in this period). The net reduction in company numbers has taken 800,000 jobs into the private sector with them, meaning that these employees lose the extra benefits of being employed by a publicly listed company.

We have demonstrated in a previous report how newly listed companies grow their workforce so significantly and the benefits to staff of being listed[5]. This report found that in the first 12 months after coming to market:

- Companies with a market capitalisation at listing of less than £1 billion grew employee numbers, on average, between 17% and 32%;
- Companies with a market capitalisation at listing of less than £500 million grew employee numbers, on average, between 20% and 34%.

From a longer-term perspective, the research showed that the workforce had doubled by year four post-IPO.

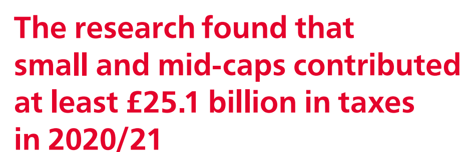
Being employed at a public company means that employees have access to ownership in their place of work and benefit directly from the success of the business, helping to drive improved job satisfaction. In addition, these companies are more transparent and are held to higher standards than private companies, due to scrutiny from investors and regulators, creating more robust companies who not only provide more stable employment but upskilling opportunities and helping to cultivate a nation of shareholders.

Taxation

The research conducted also considered the level of tax that small and mid-sized quoted companies contributed to overall tax take. The research found that small and mid-caps:

- Contributed at least £25.1 billion in taxes in 2020/21.

Their contribution amounts to approximately 5% of Income Tax and National Insurance and 9% of Corporation Tax.



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[4] QCA/Hardman & Co, May 2019, How small and mid-cap companies make a substantial contribution to markets, employment and tax revenues, available at: https://bit.ly/3MrHNbp

[5] QCA/Hardman & Co, August 2021, Good jobs come to those who IPO: The importance of going public, available at: https://bit.ly/3ChBeDK

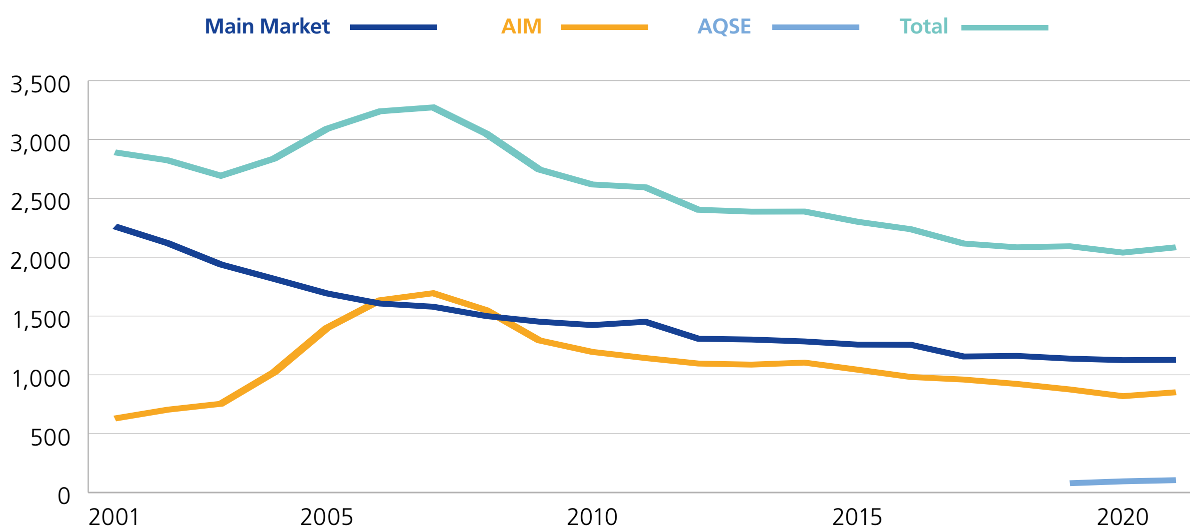
1.2 The number of companies on the Main Market, AIM and AQSE

The number of companies

Number of companies (2021)

- Main Market – 1,127
- AIM – 852
- AQSE – 105
- Combined – 2,084

Figure 3 – Number of companies historically (including financials)



Commentary: The number of companies listed on the UK's stock exchanges has been decreasing consistently for the last 20-year period. From a peak of 3,273 companies in 2007, the market has decreased by over 36% to 2,084 companies in 2021. When looking at the Main Market individually, since 2001, the number of companies on the market has decreased by 50%. The AIM market peaked in 2007 (following a developmental period after the markets inception in 1995) and has since decreased by 49%.

It is now considered that listing shares on the UK's public equity markets has become less attractive for companies due to a variety of reasons. For instance, increasingly overburdensome regulation (particularly compared to private companies), the significant costs of compliance, the growth of private equity (in part, due to significant tax subsidies), and the outdated nature of our markets have all contributed to the decline in the number of companies listed on our markets.

Serious change needs to occur to reverse this decline[6]. The recent reviews initiated following Lord Hill's Listing Review will hopefully make some improvements to the markets, but they can only go so far. Government, regulators and market operators must ensure that rule changes are complemented and supported by ongoing cultural changes towards encouraging public equity. It is the underpinning culture of these markets that will have the greatest influence on enacting behavioural change and fostering deeper and more productive markets.

The position is even more stark when financials are excluded. The Main Market, the most prestigious equity market in the UK, has just a third of the companies it had in 2000.

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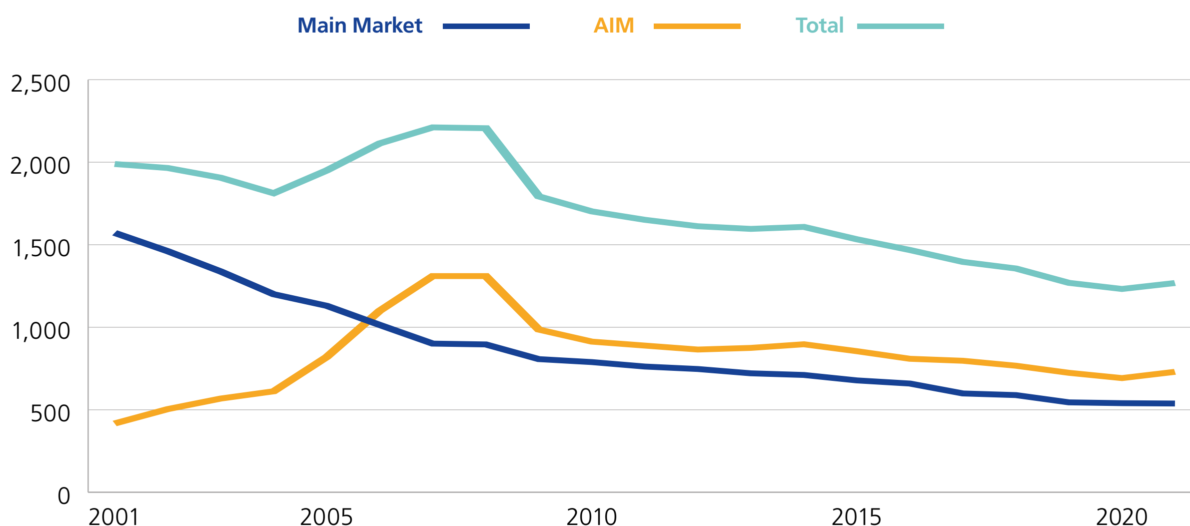
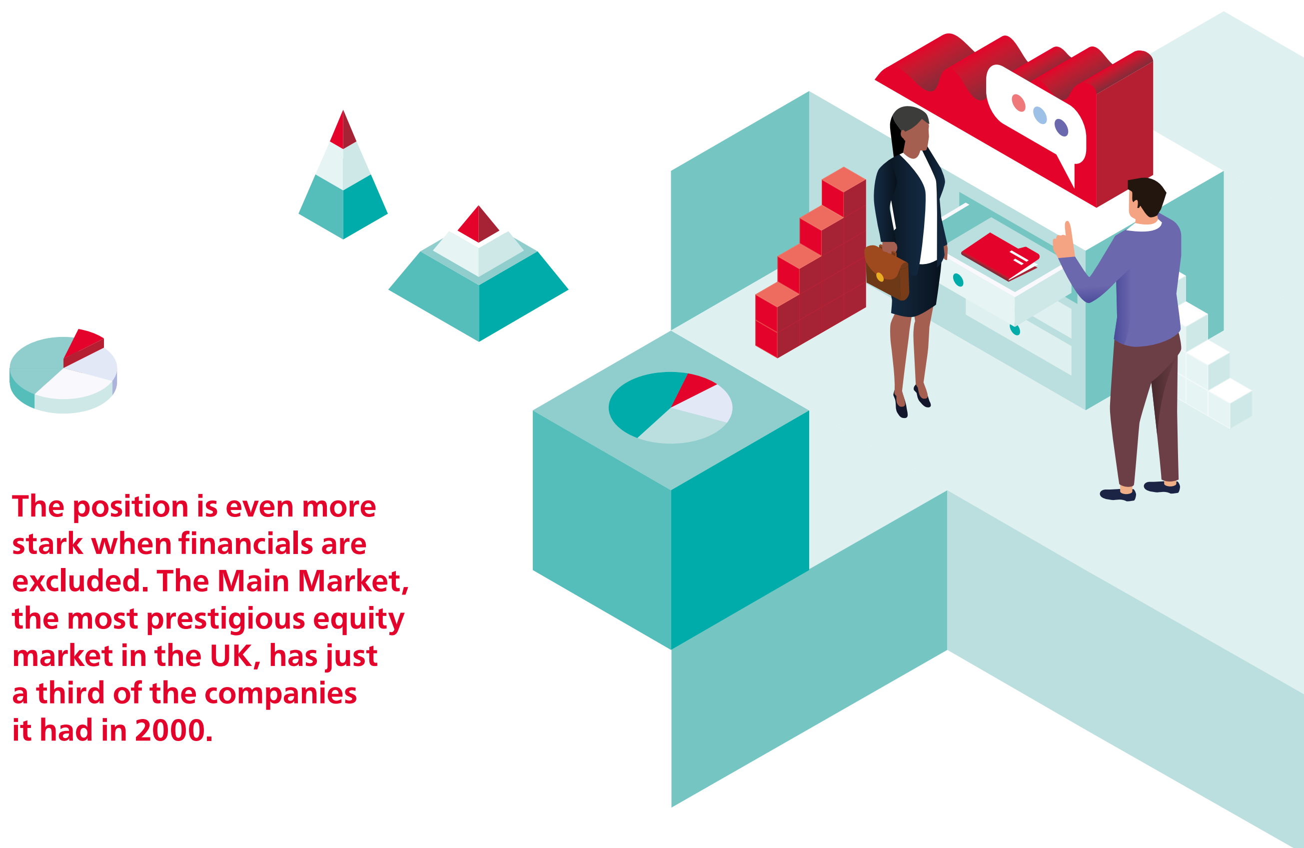
[6] We discuss solutions in Section 4 of this report.

Figure 4 – Number of companies historically (excluding financials)



Commentary: Generally, commentators agree that financial companies (e.g. investment companies and trusts, real estate investment trusts and non-equity investment instruments, amongst others) should not be included when looking at the number of companies on the market. This is because, in many ways, financials have an indirect economic impact.

Figure 4 shows the results for the number of companies (taken at the beginning of each year) excluding financials[7]. The story for the Main Market is particularly negative. As stated above, since 2001, the number of companies on the Main Market has fallen by 50%. However, when excluding financials, there is a decline of 65%.



The position is even more stark when financials are excluded. The Main Market, the most prestigious equity market in the UK, has just a third of the companies it had in 2000.

[7] Where data is stated to exclude financials, it excludes all companies within the following sectors (as defined by the LSE): Banks, British Funds, Equity Investment Instruments, Financial Services General Financial, Insurance, Investment Companies, Investment Companies Other, Life Insurance, Nonequity Investment Instruments, Non-life Insurance, Speciality & Other Finance, Real Estate, Real Estate Investment & Services, and Real Estate Investment Trusts.

New issues and further issues

Figure 5 – Number of new issues in 2021

- Main Market – 86
- AIM – 87
- Combined – 173

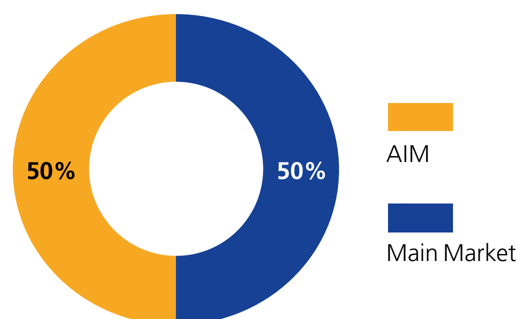


Figure 6 – Money raised from new issues (£m) in 2021

- Main Market – 6,971
- AIM – 1,853
- Combined – 8,824

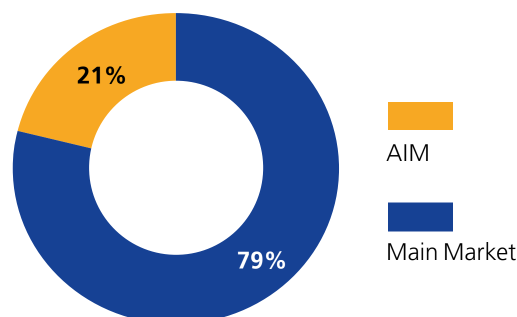


Figure 7 – Number of further issues in 2021

- Main Market – 867
- AIM – 2,005
- Combined – 2,872

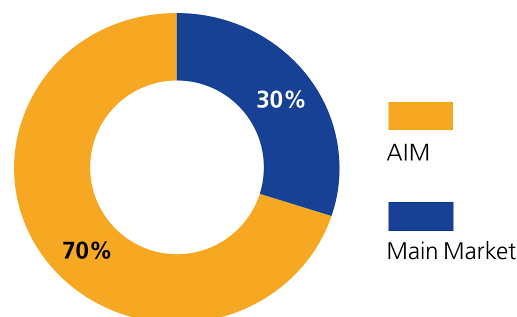
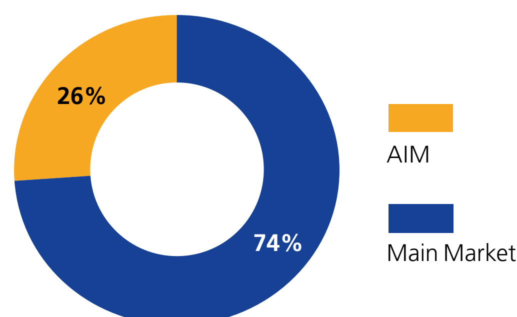


Figure 8 – Money raised from further issues (£m) in 2021

- Main Market – 19,102
- AIM – 6,873
- Combined – 25,975



Commentary: The number of new issues was broadly similar for the Main Market and AIM, however, the amount of money raised through new issues was substantially greater on the Main Market than AIM. The same can be said for the amount of money raised through further issues on the Main Market compared to AIM, however, there was a much higher number of further issues on AIM compared to the Main Market. This is due to the relative size of the companies on each market, with the larger companies on the Main Market needing to raise greater sums of money.

The size of companies by market capitalisation

Average market capitalisation (£m)

- Main Market – 3,407
- AIM – 176
- AQSE – 23

Figure 9 – Average market capitalisation of companies historically (Main Market)

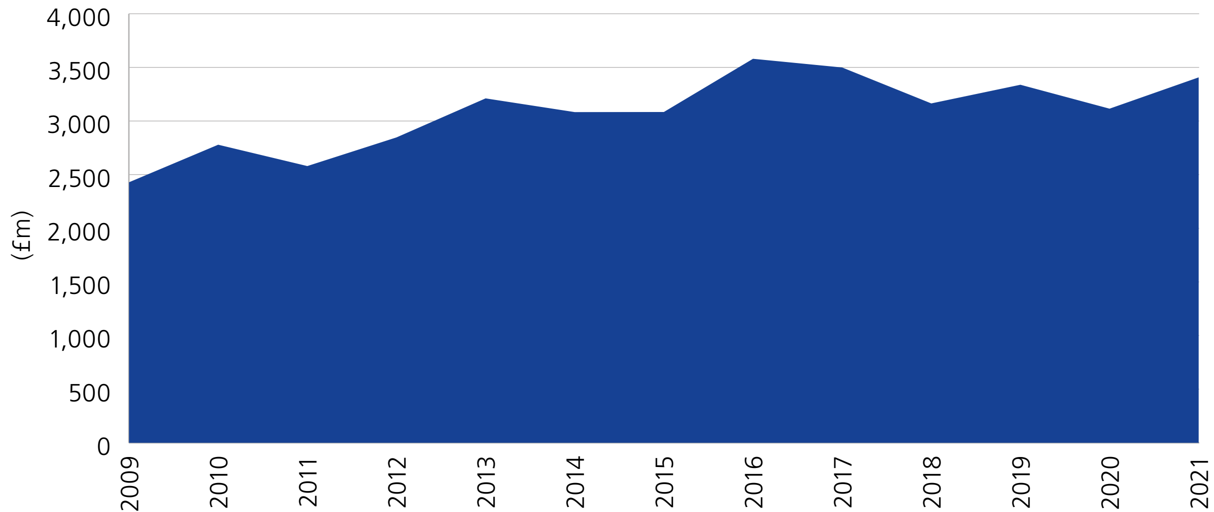
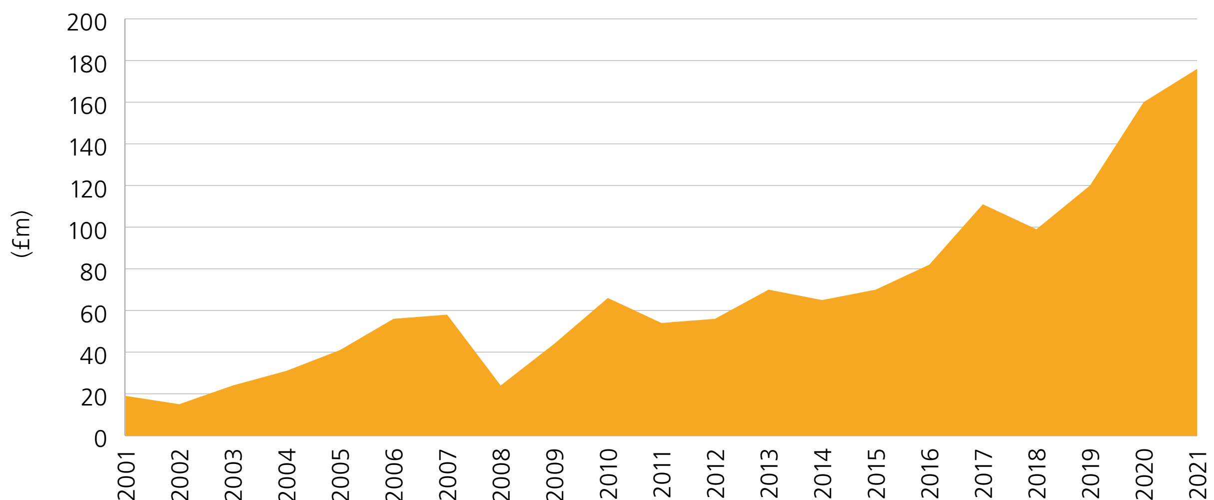


Figure 10 - Average market capitalisation of companies historically (AIM)



Median market capitalisation (£m)

- Main Market – 419
- AIM – 48
- AQSE – 6

Commentary: The information provided above demonstrates that, as expected, the average market capitalisation for Main Market listed companies is substantially higher than AIM-quoted companies. However, it is also important to consider the median market capitalisation of the companies on each markets.

Whilst the average market capitalisation of a Main Market company is over £3.4 billion (which would be described as a large-cap), the median market capitalisation is just £419 million (which we would describe as a small-cap). Similarly, the average size of an

AIM company is £176 million, and the median is much smaller at £48 million. It is important to consider the median value for each market here as the averages for each market are significantly driven up by a few very large companies, which is particularly the case for the Main Market where, despite common assumption, the majority of the companies are small and mid-caps.

In addition, Figure 9 and 10 - looking at the average market capitalisation of companies on each market – show that the size of companies on each market has grown significantly. The first graph shows that the average market capitalisation of companies on the Main Market has increased from approximately £2.5 billion in 2009[8] to £3.5 billion in 2021 (possibly due to significant change in the FTSE 100), representing an increase in average market capitalisation by approximately 40%.

In a similar vein, the second graph shows the average market capitalisation of companies on AIM has increased from approximately £20 million in 2001 to approximately £180 million in 2021, representing an increase in average market capitalisation of approximately 800%.

This demonstrates that the markets are, to some extent, closing off to smaller companies, with the average market capitalisation on both the Main Market and AIM increasing so significantly. Heightened regulatory requirements and excessive scrutiny by regulators are probable explanations as to why smaller companies are failing to join or being forced off the markets. It is also apparent that private companies are put off by the onerous nature of public markets and are choosing to list at a much later stage in their lifecycle. (Smaller companies cannot afford the resources necessary to meet disproportionate regulatory requirements). This is evidenced through the increases in both the average and median size of companies conducting IPOs. (This is discussed in greater detail in the IPO section of this report).

Smallest market capitalisation (£m)

- Main Market – 0.18
- AIM – 0.71
- AQSE – 0.1

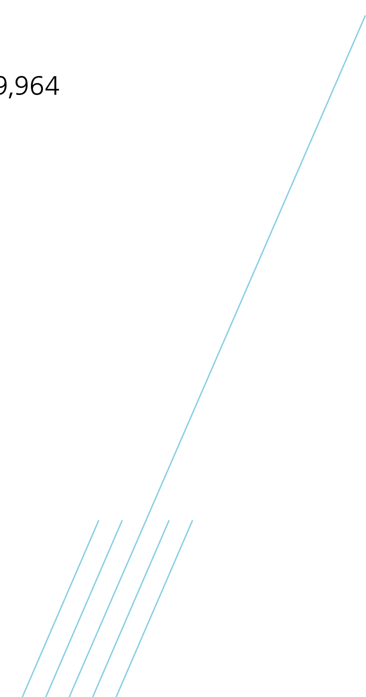
Largest market capitalisation (£m)

- Main Market – 221,202
- AIM – 4,581
- AQSE – 368

Total market capitalisation (£m)

- Main Market – 3,389,964
- AIM – 150,004
- AQSE – 2,308
- Total – 3,542,276

Commentary: To put this into a global context, London is considerably smaller compared with many stock exchanges throughout the world. In fact, London (Main Market and AIM combined) is the 8th largest stock exchange in the world. The US (NYSE and NASDAQ), Shanghai, Euronext, Japan, Shenzhen and Hong Kong all have larger total market capitalisations than the UK. This is concerning as London could quickly become a global backwater as the US and Asian markets surge ahead. Foreign exchanges benefit from being more dynamic and expansive and are leading the way in many of the new industries, including fintech, renewables, and artificial intelligence. This has resulted in companies from all over the world, including the UK, tending to consider these markets ahead of London as the destination to list.



The ability of AIM companies to grow and innovate is substantial, and they hold the solutions to the future needs of a modern, sustainable economy

[8] The data for the Main Market on the LSE's website only goes back to 2009.

The UK must take heed from US and Asian policymakers who can be relied upon to support and enhance the stock market by modernising, actively promoting and innovating. Failure to follow suit will result in the UK falling further behind; we must encourage growth and innovation as a priority.

For instance, Japan recently reconfigured its equity market offering to establish three different market segments[9] in order to incentivise companies and provide different offerings to reflect the different natures of companies.

Meanwhile, the US continues to attract and retain the most exciting healthcare, retail and technology companies and has three different market tiers for different types of companies.

Both these examples serve to illustrate how these market operators provide a clearly differentiated choice, which, in turn, increases the confidence of companies that the markets are designed for their specific wants and needs.

Notwithstanding the above, the UK is the only market with a successful and vibrant smaller company public market of scale. The ability of AIM companies to grow and innovate is substantial, and they hold the solutions to the future needs of a modern, sustainable economy. AIM must be nurtured and protected to avoid this market diminishing further.

The distribution of companies by market capitalisation

Figure 11 – Distribution of companies by equity market value (Main Market: 2021)

2021 Market Value Range (£m)	Number of Companies	Equity Market Value (£m)
Over 50 billion	15 (1.3%)	1,474,590.34 (38.4%)
10-50 billion	57 (5.1%)	1,334,409.03 (34.8%)
5-10 billion	51 (4.5%)	356,140.05 (9.3%)
2-5 billion	102 (9.1%)	328,206.21 (8.5%)
1-2 billion	168 (14.9%)	211,446.94 (5.5%)
500-1000 million	79 (7%)	50,113.64 (1.3%)
250-500 million	146 (13%)	52,215.32 (1.4%)
100-250 million	144 (12.8%)	24,223.63 (0.6%)
25-100 million	121 (10.7%)	7,434.52 (0.2%)
0-25 million	255 (22.6%)	1,184.70 (0.0%)

[9] Japan Exchange Group, Overview of Market Restructuring, available at: https://bit.ly/3g2ieBT

Figure 11.1 – Number of companies by equity market value (Main Market)

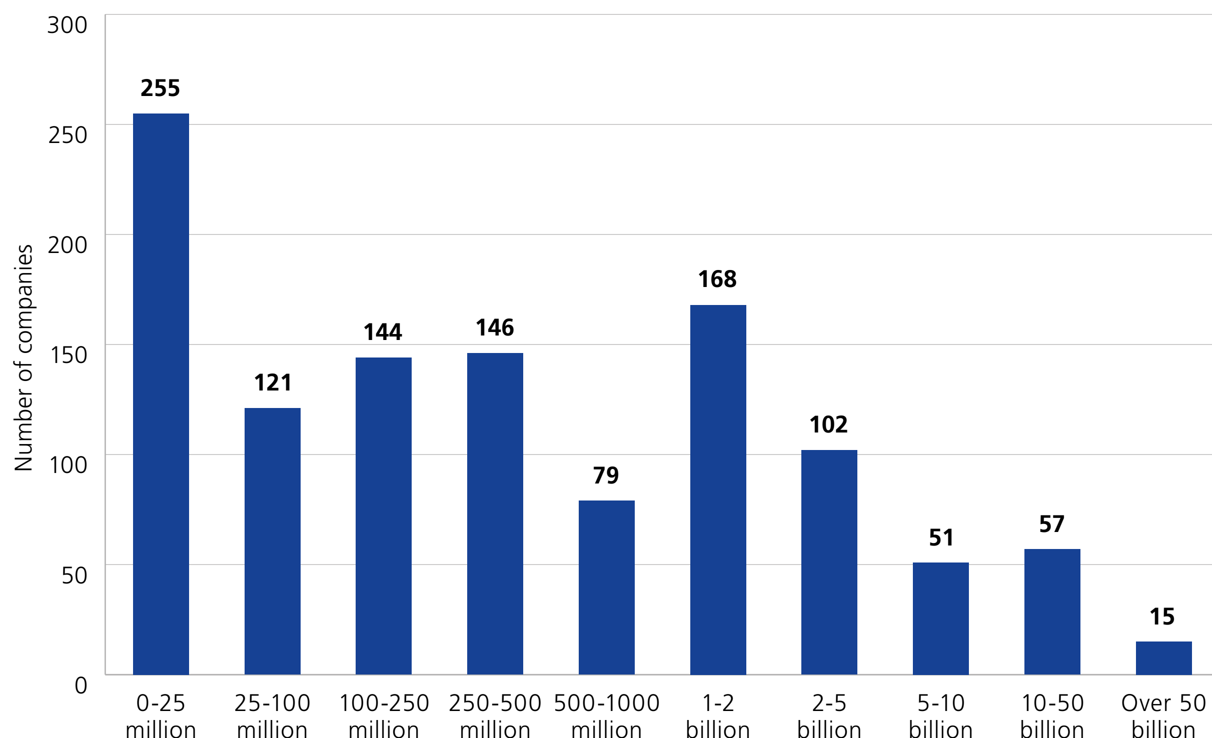


Figure 12 – Distribution of companies by equity market value (AIM: 2021)

2021 Market Value Range (£m)	Number of Companies	Equity Market Value (£m)
Over 1,000	30 (3.5%)	55,890.23 (37.3%)
500-1000	43 (5%)	55,890.23 (20%)
250-500	61 (7.2%)	21,601.28 (14.4%)
100-250	169 (19.8%)	26,177.83 (17.5%)
50-100	114 (13.4%)	8,201.64 (5.5%)
25-50	135 (15.8%)	4,918.21 (3.3%)
10-25	140 (16.4%)	2,259.18 (1.5%)
5-10	96 (11.3%)	693.37 (0.5%)
2-5	50 (5.9%)	171.89 (0.1%)
0-2	14 (1.6%)	21.37 (0.0%)

Figure 12.1 – Number of companies by equity market value (AIM)

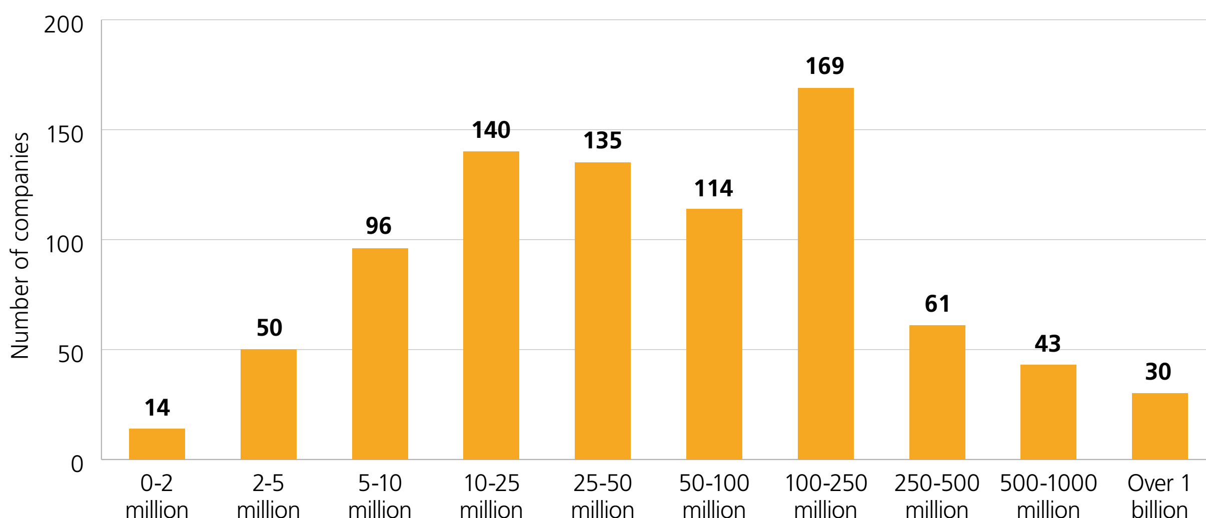
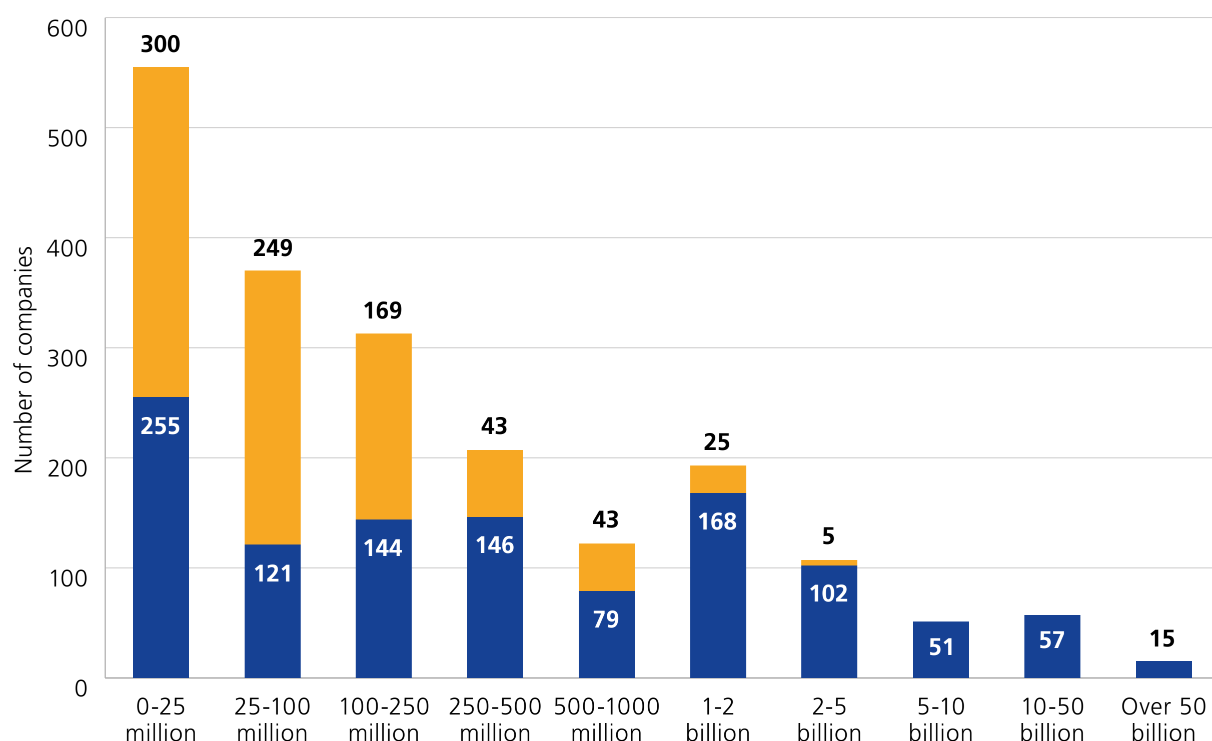


Figure 13 – Distribution of companies by equity market value (Main Market and AIM: 2021)



Commentary: Figure 13 reveals the distribution of companies on the Main Market and AIM by their market capitalisation. The graph shows that nearly two thirds of the companies on the markets have a market capitalisation below £250 million. Moreover, nearly half of the companies have a market capitalisation below £100 million, and over a quarter of them have a market capitalisation of just £0-25 million. Nearly 80% of companies have a market capitalisation below £1 billion.

Many market participants, including fund managers, consider companies with a market capitalisation below £1 billion to fit in the 'small-cap' bracket. The fact that these companies account for 80% of the market demonstrates that these companies should not be an afterthought. Policy and perspectives on the market should reflect the evidence – that the vast majority of publicly listed companies fit within this bracket.

Only when this is hard-coded into our thinking and actions, and these companies are placed at the centre, will the public good nature of our equity markets be furthered.

There is a common misconception that surrounds the perceived size of companies on the UK's public markets. Incorrect assumptions are regularly made about the size of public companies, namely: (i) that, due to their inherent nature as a 'public' company, they are assumed to be 'large'; and (ii) that Main Market companies are significantly bigger than AIM-quoted companies. This has caused many poor policy decisions in many initiatives over the last 20 years.

We have witnessed these assumptions being used for policy decisions frequently by ministers, civil servants, and officials within the regulators. These individuals, who often have decision-making powers, are not market practitioners and do not have the same level of informed understanding that market practitioners do about the many intricacies involved.

It is imperative that more experienced staff are brought into Government and the regulators to ensure that this does not continue. A potential model to consider would be that operated by the Takeover Panel. The Panel's executive comprises a significant cohort of market practitioners, representing a wide spread of expertise, covering large and small companies.

Therefore, to address the first assumption (i) the significant majority of public companies are not large; in fact, more often than not, they should be categorised and treated as smaller, growth companies.

Regarding the second assumption (ii), Figure 13 displays that, while the companies on the Main Market are larger in terms of total market capitalisation, they are often similar in size to many AIM-quoted companies. For instance, of the 80% of companies that have a market capitalisation below £1 billion, 52% of the companies are on AIM and 48% of the companies are on the Main Market.

In addition, Figure 11 and Figure 12 show that the distribution in terms of equity market value is significantly concentrated at the top end of the Main Market. ***The largest 11% of companies represent 82.5% of the total market capitalisation***, with the other 89% of companies making up the remaining 17.5% of the total market capitalisation.

Furthermore, as of 29 April 2022, the largest company in the FTSE All-Share Index had a market capitalisation of £165,917 million, with the smallest company having a market capitalisation of just £20 million[10]. This means that the smallest company is 0.01% of the size of the largest, or nearly 8,300 times smaller.

Despite the evidence that the majority of companies on the UK's exchanges are small and mid-sized quoted companies, legislation and regulation is invariably targeted to regulate the largest companies. Policy inevitably lacks proportionality, with Government and regulators adopting a one-size-fits-all approach that is extremely damaging to our markets. We need to ensure that more experienced staff are appointed within the civil service and the regulators. The cost of retrospectively adjusting regulation to meet the needs of small-caps is a significant drain on economic and regulatory resources. Many one-size-fits-all judgements cannot be reversed, irrevocably cementing unattractive features into our markets.

We must also take note that the markets are populated with a significant number of small and micro-cap companies, which have largely been ignored. There is currently a frenzy because of the lower cost of capital off market. This is not just about the cost of debt, but also about the quantum of capital, lack of diversity in that capital and the regulation of capital, all of which contribute to diminishing liquidity and higher costs of capital. The intent behind protecting investors is understood and well meant, but by making it more difficult to invest we are chasing capital away from micro and small caps by reducing risk appetites. The result of this is much greater as there is a huge missed economic and social opportunity cost from the underinvestment that follows.

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[10] FTSE Russell website, FTSE Factsheets, FTSE All-Share Indexes

Furthermore, and as a result of globalisation, many institutional investors limit their equity investments solely to mid and large-caps, believing that they can deliver attractive outcomes for their clients over the longer term. Globalisation has led to institutional investors having an overreliance and overconfidence in large companies due to their global nature. This has led to few institutional investors having the knowledge of market patterns other than those dominant during globalisation. If they had, they would know that at nearly all times, attractive client outcomes could only be achieved by including significant weightings of smaller company stocks.

The level of disinterest in smaller company stocks during the years of globalisation has weakened the vibrancy of the smaller quoted company universe. However, as we are now entering a period beyond globalisation, many investors will relearn how they need to balance their portfolios with both large company stocks and small company stocks. In that regard, the survival of UK small and micro-cap infrastructure offers us the potential to become the global leader in quoted smaller companies, as renewed interest and capital allocation by institutions drives extraordinary upside potential from the sector.

The type of sectors

Figure 14 – Range and number of sectors

Sector	Market		
	Main Market	AIM	AQSE
Automobiles and parts	4	4	0
Banks	32	1	0
Basic resources	67	116	6
Chemicals	11	9	1
Construction and materials	21	20	1
Consumer products and services	29	32	1
Energy	50	98	2
Financial services	457	91	53
Food, Beverage and Tobacco	28	18	6
Healthcare	26	91	8
Industrial goods and services	108	122	2
Insurance	22	3	0
Media	21	29	1
Personal care, drug and grocery stores	19	6	0
Real Estate	73	25	6
Retail	27	23	2
Technology	43	107	7
Telecommunications	14	15	1
Travel and Leisure	42	31	7
Utilities	23	9	0

Commentary: The UK's markets have a noticeable lack of companies in globally dominant sectors, such as technology, and new and emerging industries, such as fintech, renewables, mobility, biotech, agritech, cybersecurity, e-commerce, and artificial intelligence. Collectively, London has just 150 public technology companies, and only 43 of these are listed on the Main Market. It is evident that London is struggling to attract leading tech company listings, with the NYSE and NASDAQ being the first choice for many tech companies. When techMark was launched by the London Stock Exchange in 1999 there were 189 technology companies on the Main Market by 2000.

The performance of tech IPOs on the LSE has also been poor, with those in the US sometimes (but not always) being able to access deeper pools of capital and receive higher valuations. Whatever the reality, the perception is that the US is more welcoming and has more critical mass for technology companies. The issue goes further, with many UK tech companies that listed in the UK being vulnerable to foreign acquisitions. This has been caused as the deeper issues associated with funding young companies have not been addressed.

Whilst Government and regulators are focussed on making changes to our markets following Lord Hill's Listing Review and Ron Kalifa's Review of Fintech, these reforms have only scratched the surface. Government and regulators must focus on the fundamentals to create inspiring markets that are fit for the future, as well as encouraging a deeper, cultural change to enable more capital to be invested into listed equities. This will not only help to make a difference at the point of flotation, but also will do more to keep tech companies in London over the longer-term.

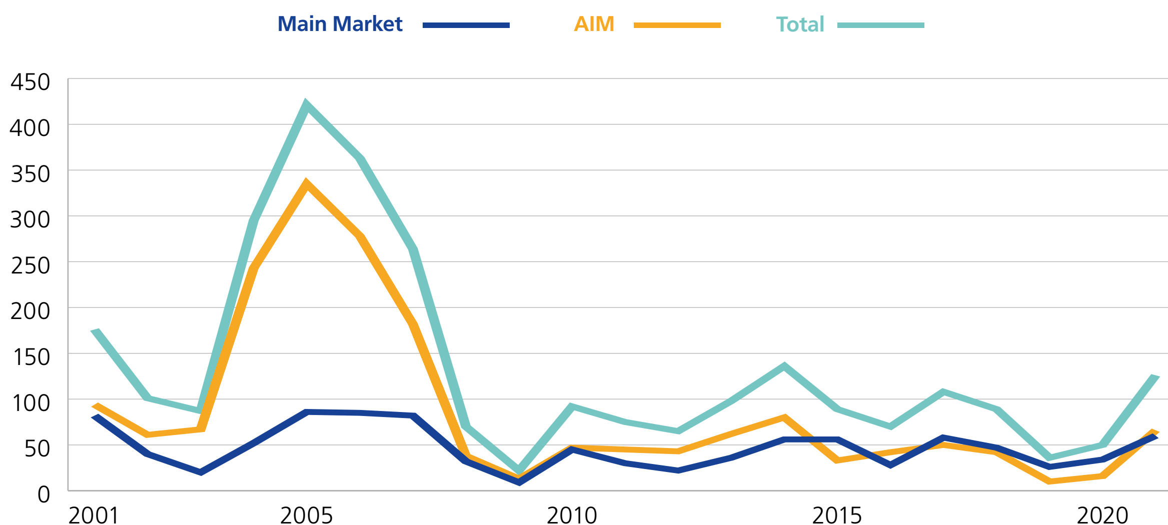
In addition to this, London, and in particular the Main Market, is dominated by financial services and investment companies. On the Main Market, financial services companies represent around 40% of the total market. Financial services companies are not the same as trading companies. For instance, closed end investments, equity investment instruments, investment companies, investment trusts, Real Estate Investment Trusts and Venture Capital Investment Trusts, differ from trading companies in that they only reflect an indirect economic impact through investing in trading companies.

1.3 The number of IPOs on the Main Market and AIM

The number of IPOs

- Main Market – 60
- AIM – 66
- Combined – 126

Figure 15 – The number of IPO's historically



Commentary: Figure 15 illustrates the number of IPOs on the Main Market and AIM over the last twenty years (since 2001). The graph shows a gradual decline in the number of companies conducting an IPO over the twenty-year period, noting several dips, such as during the financial crisis and the Covid-19 pandemic. Over the period displayed in the graph, the average number of IPOs per year is 134. However, this figure has only been achieved once in the last 14 years. It should also be noted that, despite a positive jump in the number of IPOs in 2021 following the end of the pandemic, 2022 has, so far, witnessed a slowdown in the number of companies conducting an IPO. Current market conditions created as a result of adverse macroeconomic factors and geopolitical issues have, of course, contributed to this slowdown, but we cannot ignore the longer-term trends and continue to use these conditions and others in the future, as excuses for the longer-term decline in our markets.

Moreover, the number of listings frequently attracts attention from a variety of commentators who view the UK's IPO figures in isolation, proclaiming that the numbers in any year are positive. However, it is important to also factor in the number of de-listings, which consistently outpaces the number of listings[11]. Moreover, the size of companies conducting an IPO has increased.

The amount of money raised in new shares in 2021

Money raised in new shares (£m)

- Main Market – 6,662
- AIM – 1,455

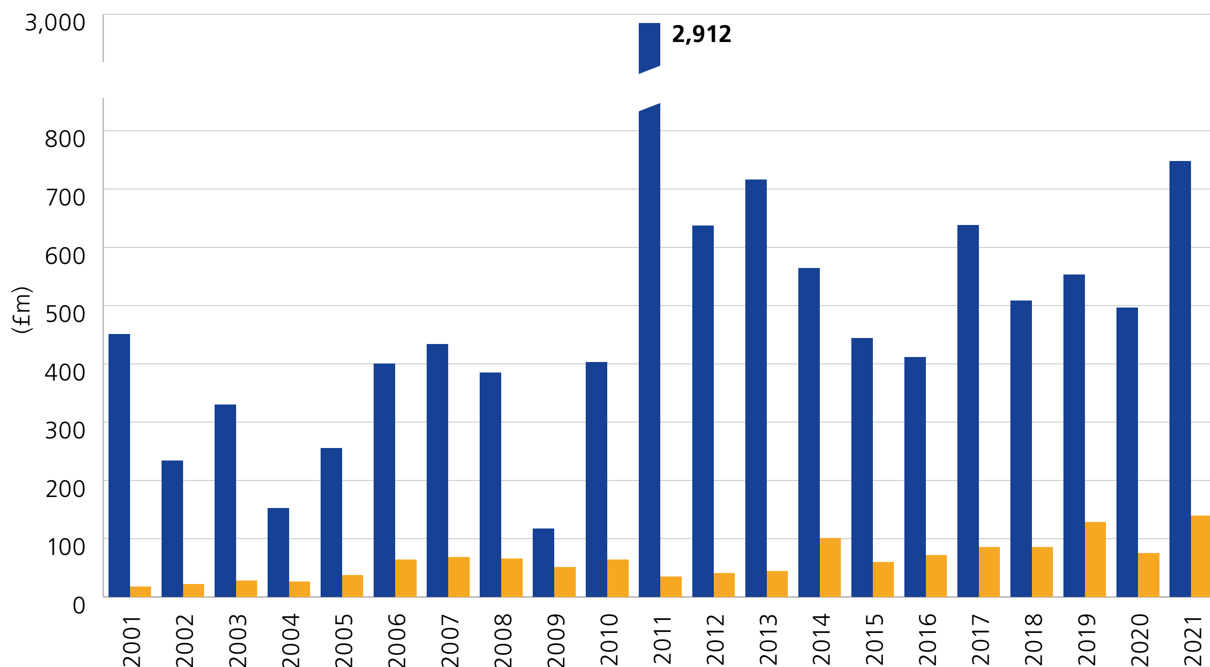
The size of the companies who have conducted an IPO in 2021

Average market capitalisation (opening price) (£m)

- Main Market – 748
- AIM – 138

[11] This is discussed in greater detail in the section below on de-listings.

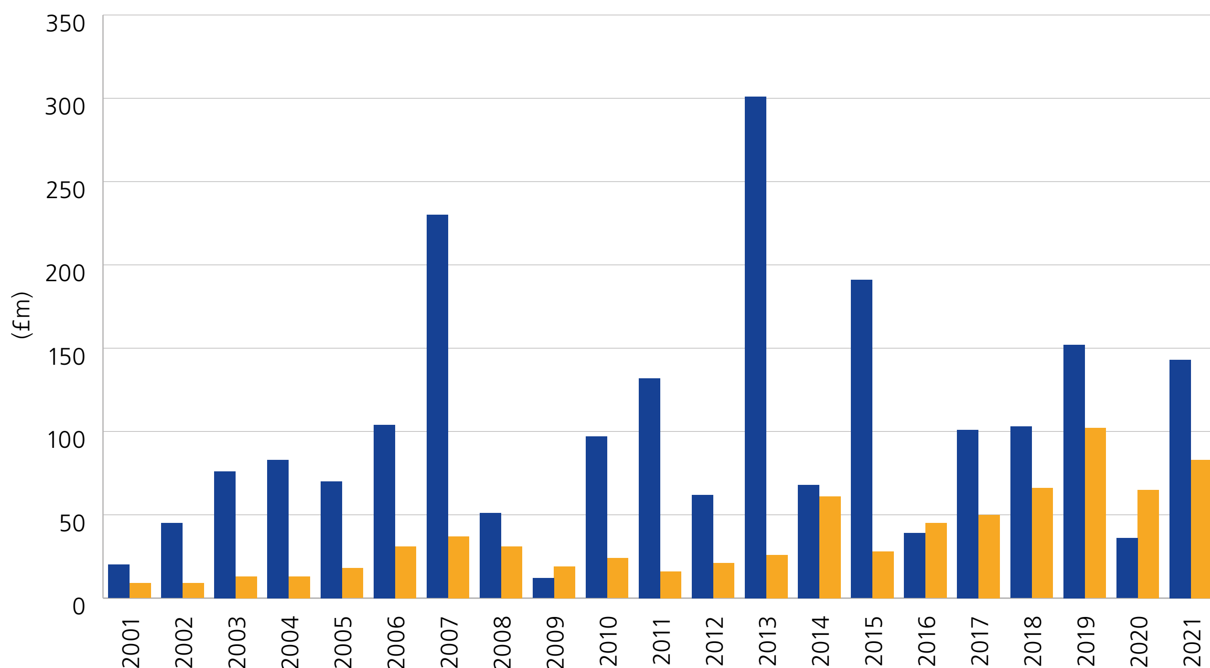
Figure 16 – The average size of companies conducting an IPO historically



Median market capitalisation (opening price) (£m)

- Main Market – 143
- AIM – 83

Figure 17 – The median size of companies conducting an IPO historically



Smallest market capitalisation (opening price) (£m)

- Main Market – 0
- AIM – 12

Largest market capitalisation (opening price) (£m)

- Main Market – 5,971
- AIM – 986

Total market capitalisation (opening price) (£m)

- Main Market – 44,856
- AIM – 9,138

Commentary: Over the past twenty years, the average and median size of companies conducting an IPO has grown significantly. During the ten-year period between 2001 and 2010, the average size of a company conducting an IPO on the Main Market was £316 million and the median was £79 million. During the ten-year period between 2012 and 2021, the average size was £518 million[12] and the median size was £120 million. The same story is evident for AIM with the average market capitalisation upon listing between 2001 and 2010 being £44 million and median being £20 million, and the average between 2012 and 2021 being £83 million and the median being £55 million.

This reinforces the message that the markets are become weighted towards larger companies, with smaller companies avoiding them due to a number of factors including the one-size-fits-all approach that disproportionately impacts them. Private companies can also be put off by this and choose to list at a later stage in their lifecycle, which is evidenced by the increase in size of companies conducting IPO's over the last twenty-year period.

The type of sectors conducting an IPO

Figure 19 – Range and number of sectors

Sector	Market	
	Main Market	AIM
Automobiles and parts	0	2
Banks	1	0
Basic resources	4	4
Chemicals	0	0
Construction and materials	1	2
Consumer products and services	4	1
Energy	2	1
Financial services	23	3
Food, beverage and tobacco	0	1
Healthcare	4	7
Industrial goods and services	2	10
Insurance	0	0
Media	0	1
Personal care, drug and grocery stores	0	1
Real estate	0	1
Retail	2	4
Technology	7	6
Telecommunications	1	0
Travel and leisure	0	2
Utilities	1	0
Unknown	9	18

[12] 2011 has been left out as an anomaly.

Commentary: 2021 witnessed a positive upturn in the number of companies conducting an IPO, possibly representing years of decision hiatus as a result of political and economic uncertainties in relation to Brexit and the Covid-19 pandemic. With this positive upturn, there was a relatively good spread in terms of the number of sectors of companies conducting a listing.

However, as argued earlier in this report, financial services companies dominate and technology companies are significantly under-represented, especially when compared to those markets in the US and Asia. The UK needs to move away from its association with being the home for banks, investment companies and insurers and needs to reflect the increasing shift towards fast-growth sectors, such as technology, science and e-commerce.

The number of companies transferring between markets

- Main Market to AIM – 5
- AIM to Main Market – 3

The number of international companies conducting an IPO in the UK

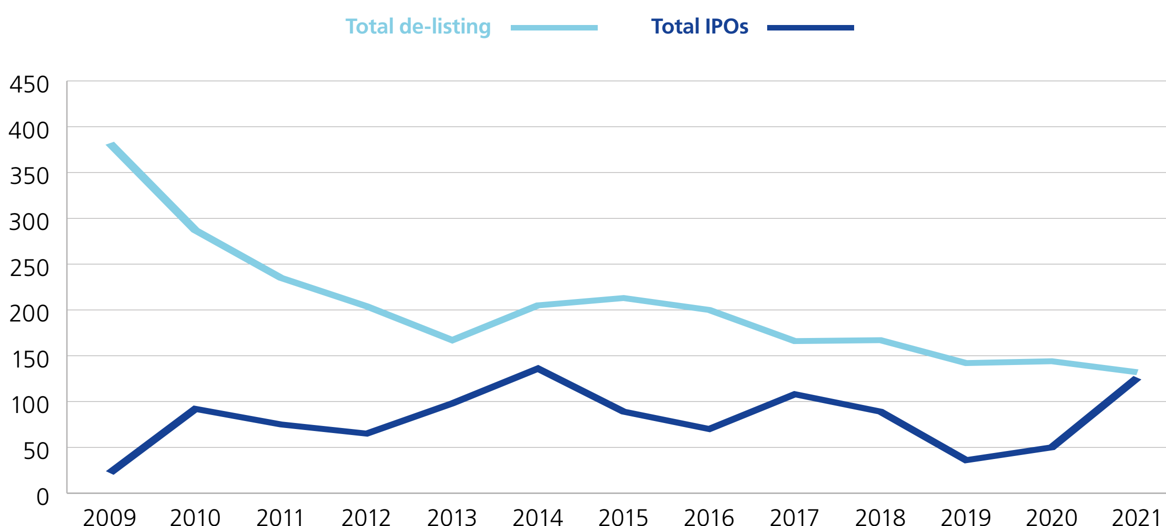
- Main Market – 6
- AIM – 12

1.4 The number of de-listings on the Main Market and AIM

The number of de-listings

- Main Market – 78
- AIM – 53

Figure 20 – De-listings vs IPOs



Commentary: the number of listings frequently attracts attention from a variety of commentators who view the UK's IPO figures in isolation, proclaiming that the numbers are positive. However, it is important to also factor in the number of de-listings, which consistently outpaces the number of listings.

For instance, despite a very positive year for IPOs in 2021 (126 in total), there were 131 de-listings. The gap between the number of de-listings and IPOs gets worse when looking at previous years. The de-equitisation threat is considerable, with more and more companies being subject to takeovers by private equity firms.

Figure 20 shows that the number of companies de-listing outpaces the number of IPOs every year during the period 2009-2021 (please note that the data on the LSE's website only goes back to 2009 for de-listings, hence the selection of this period).

2: Attitudes and Sentiment

This section features the results of the QCA/Peel Hunt Small and Mid-cap survey[13] and the QCA/YouGov Sentiment Survey[14]. All data within this section have been extracted from these two reports.

2.1 Results of the QCA/Peel Hunt Small and Mid-cap Survey (published January 2022)

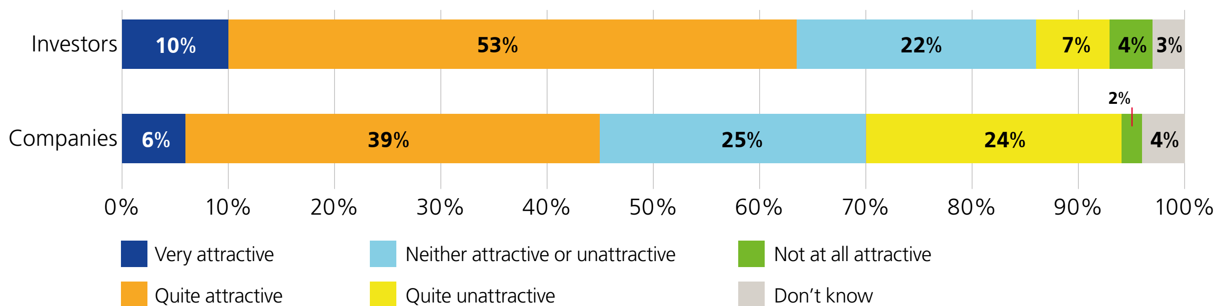
The results of the QCA/Peel Hunt Small and Mid-cap survey collate the views of 126 UK-based fund managers and 118 small and mid-cap UK quoted companies. The survey explored their attitudes towards a range of key subjects.

Market attractiveness

The attractiveness of UK public equity markets

- 45% of companies think the UK market is attractive
- 63% of investors think the UK market is attractive

Figure 21 – How attractive would you say public markets are for small and mid-caps currently?



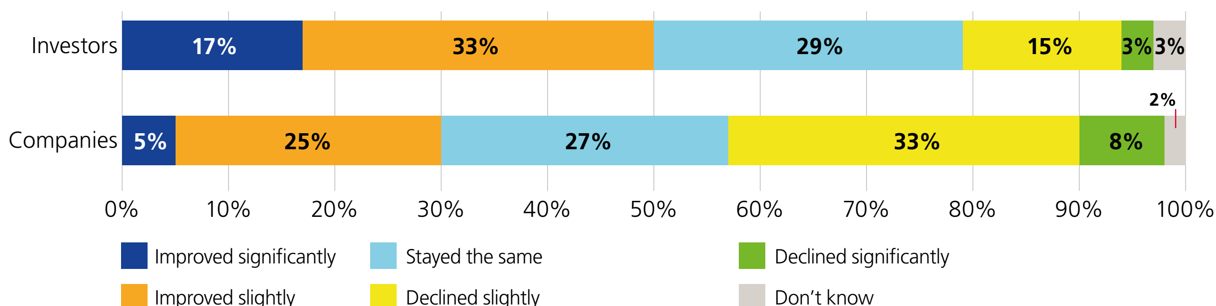
[13] QCA/Peel Hunt Small and Mid-cap Survey 2022, The eye of the beholder: The differing perspectives on the UK's equity markets, available at: https://bit.ly/3MpcIVV
[14] QCA/YouGov Small and Mid-Cap Sentiment Survey, 2022, available at: https://bit.ly/3Mn8pdz

Commentary: The attractiveness of public markets for small and mid-caps is seen very differently by companies and investors. Less than half of the companies say public markets are attractive, and a quarter view them as unattractive. By contrast, almost two-thirds of investors think public markets are attractive for small and mid-caps companies and just a tenth consider them to be unattractive. What is deeply concerning is that only 10% of investors and 6% of companies view the markets as very attractive. This perception must be reversed if we are to encourage the greater use of our markets by both companies and investors.

The attractiveness of public markets over the last 12-month period

- 30% of companies think the attractiveness of the UK market has improved over the last 12 months
- 50% of investors think the attractiveness of the UK market has improved over the last 12 months

Figure 22 – How has the attractiveness of public markets changed for small and mid-caps in the past 12 months?



Commentary: In addition to the above, there is also a significant difference between companies' and investors' views towards the developing attractiveness of the markets. 6 in 10 companies believe that attractiveness of public markets has either stayed the same or decreased, yet half of investors believe that the attractiveness of public markets has improved over the past 12 months.

There is broad agreement between companies and investors on how to improve the current listing environment. Relaxing regulation and reporting requirements are frequently mentioned by investors as effective ways to improve the public listing market for small and mid-caps. Company directors tend to agree, emphasising that ***perception issues*** are also a hinderance.

Current difficulties for small and mid-cap companies

The most frequent difficulties cited by companies and investors are ***liquidity*** and ***supply chain issues***. In terms of liquidity, investors stated that there has been an increasing focus on moving up the market cap size to avoid liquidity issues, with the ability of smaller companies to attract money becoming very difficult as a result.

Company directors also stressed that increasing volumes of ***regulation, governance and compliance*** expectations are some of the main challenges, particularly as a result of internal resource constraints. Companies also highlighted that economic uncertainty, as a result of ***Covid-19*** and ***geopolitical instability*** means it is harder to meet performance expectations.

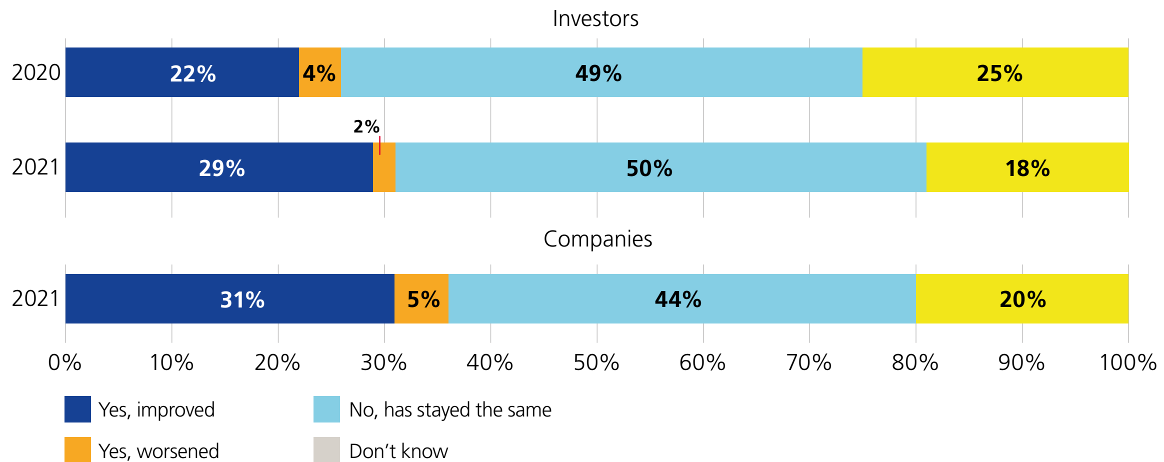
Relaxing regulation and reporting requirements are frequently mentioned by investors as effective ways to improve the public listing market for small and mid-caps

Corporate governance and ESG

The quality of corporate governance in the past year

- Almost 50% of investors believe that the quality of corporate governance has not changed
- 44% of companies believe that the quality of corporate governance has not changed
- Companies and investors are much more likely to think that the quality has improved rather than worsened

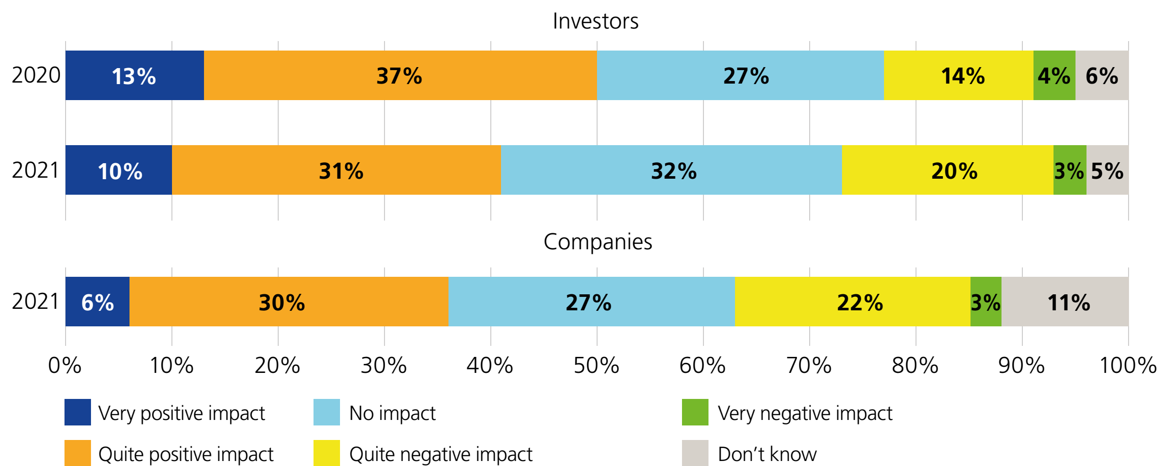
Figure 23 – Has the quality of corporate governance in small and mid-caps changed in the past 12 months?



The impact of the rise in ESG funds

- Half of investors believe that the rise of ESG funds will have a positive impact on the attractiveness of public markets
- Around a third of companies believe that the rise of ESG funds will have a positive impact on the attractiveness of public markets

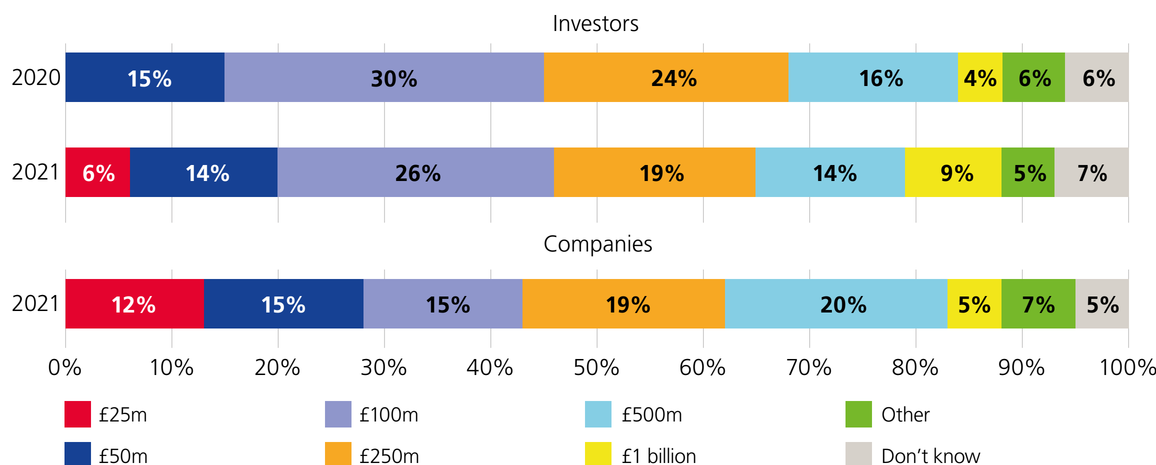
Figure 24 – What impact do you think the rise of ESG funds will have on the overall attractiveness of public markets for private companies?



Minimum market capitalisation for the Main Market

In terms of views towards what the minimum market capitalisation a company should have before considering listing on the Main Market, companies and investors are split. Most investors suggest £100 million as the minimum and most companies would suggest £500 million. This perhaps suggests a greater sense of awareness from companies of the cost of bearing a heavy regulatory burden.

Figure 25 – What do you think is the minimum size in terms of market capitalisation that a company should have before it considers a listing on the Main Market?

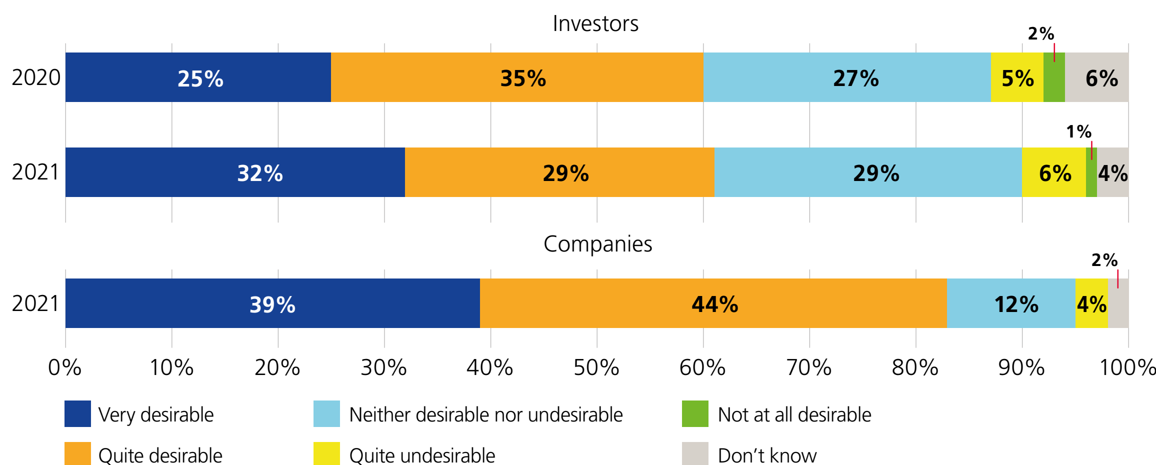


Retail investors

The importance of retail investors

- Over four-fifths of companies see retail investors as desirable
- 6 in 10 investors view retail investors as a desirable feature of a company's share register, with very few seeing them as undesirable

Figure 26 – How desirable or undesirable do you consider retail investors to be as a feature of a company's share register?



Commentary: Throughout the history of the QCA/Peel Hunt Small and Mid-cap survey, we have seen companies increasingly recognise the importance of retail investors. There is an increasing recognition that retail investors are loyal, long-term providers of capital that broaden the share register. They also offer essential liquidity for small and mid-cap quoted companies where it often would not exist to the same extent without it.

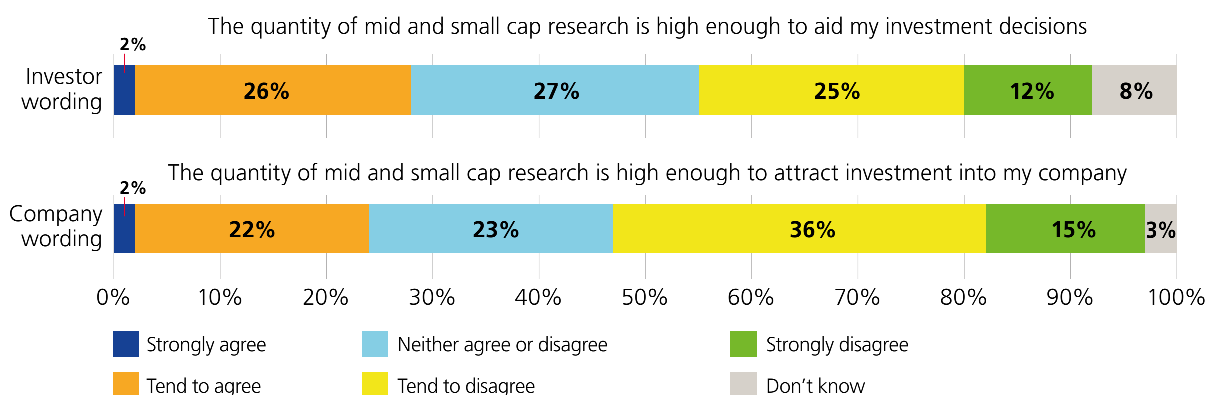
It is essential that retail investors are provided with the opportunity to participate in IPOs and secondary fundraisings. Alterations to the investment advertisement regime to allow retail to participate in the way they can in crowd funding transactions, as well as allowing research to be distributed to retail investors, would improve the markets for small and mid-cap companies. Increasing retail participation could produce the effect of enticing more private companies to list on a public market at an earlier stage in their lifecycle. We welcome and endorse the findings of Mark Austin's Secondary Capital Raisings Review.

The quantity and quality of research

The quantity of research

- Less than 3 in 10 investors agree that the quantity of research is high enough to aid investment decisions
- Over half of companies disagree that the quantity of research is high enough to attract investment into small and mid-caps

Figure 27 – To what extent to you agree or disagree with the following statements?



Commentary: MiFID II is frequently cited as the key issue when it comes to the production of research on small and mid-cap companies. This has resulted in investors having to pay for broker research, meaning a lot of it is no longer produced and there are no longer the business models that encourage multiple sources of research about smaller quoted companies.

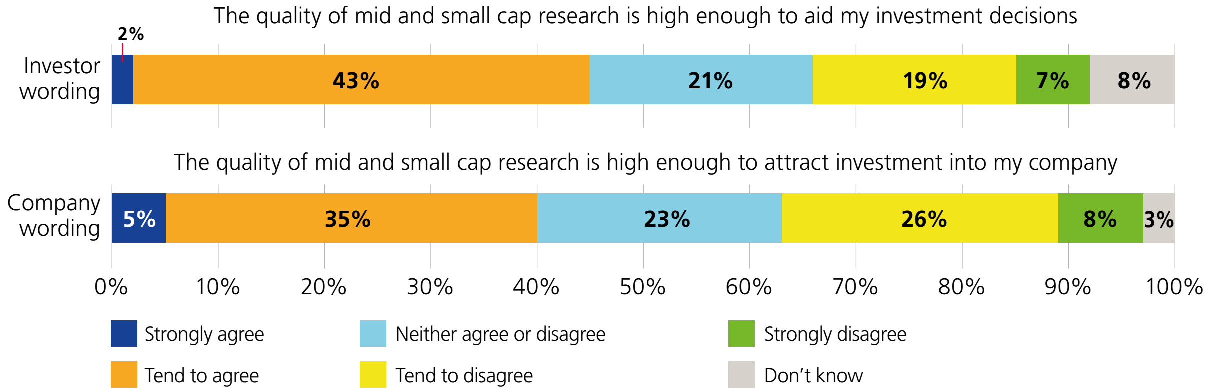
The nature of small and mid-sized quoted companies dictates that research coverage is the only realistic and affordable means by which they can increase their visibility to the market through the provision of quality investment research. Research eases price discovery and enhances liquidity, which in turn reduces the cost of capital for companies and encourages their growth. Partly as a result of MiFID II, less research is being produced and there are fewer brokers participating in the small-cap segment of the market, which has led to lower liquidity, greater share price volatility and higher-bid offer spreads. This has resulted in increased costs associated with raising finance, coupled with reduced institutional access.

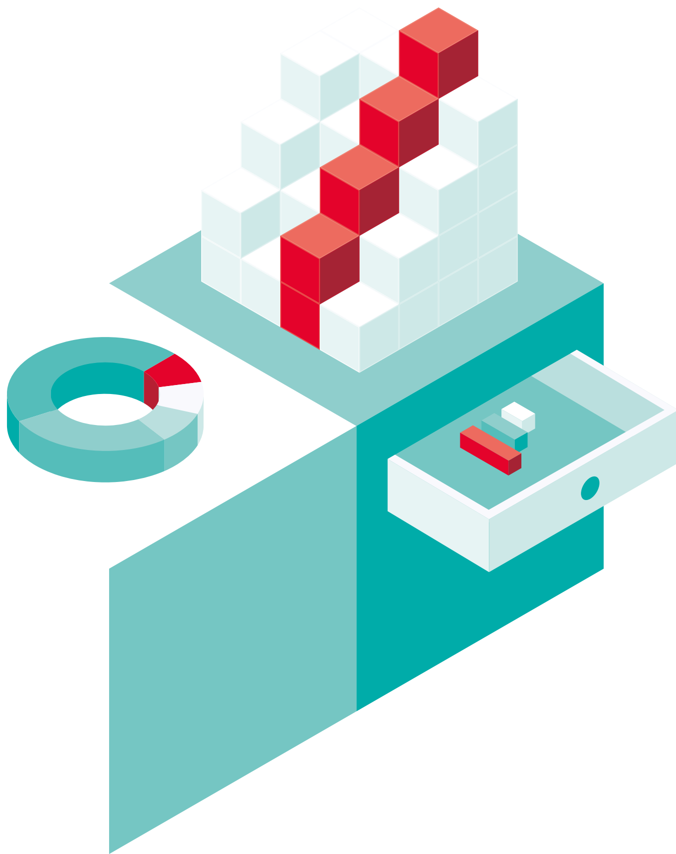
While the FCA recently announced a policy change to exempt small and mid-cap companies with a market capitalisation below £200 million from the inducement rules, which was welcomed by our community, more needs to be done to encourage greater output on research for these companies. With much of the damage already done, the new exemption is likely to have minimal impact. Large investment banks and brokers have invested heavily in revising their business models and measures for the inducement rules and it is now too cumbersome and costly to withdraw these processes. It is necessary to build up the mass of analysts and experts covering small and mid-caps companies, to reach a scale that helps to create more demand by investors for the companies.

The quality of research

- 45% of investors agree that the quality of research is high enough to aid investment decisions, although over a quarter do not
- There is almost an equal split between companies that believe the quality of research is high enough to attract investment into their companies and those who do not

Figure 28 – To what extent to you agree or disagree with the following statements?





2.2 Results of the QCA/YouGov Sentiment Survey (published April 2022)

NOTE: The QCA/YouGov Sentiment Survey is updated regulalrly. The results for H2 of 2022 will be released later this year. Please refer to our website for updates on this.

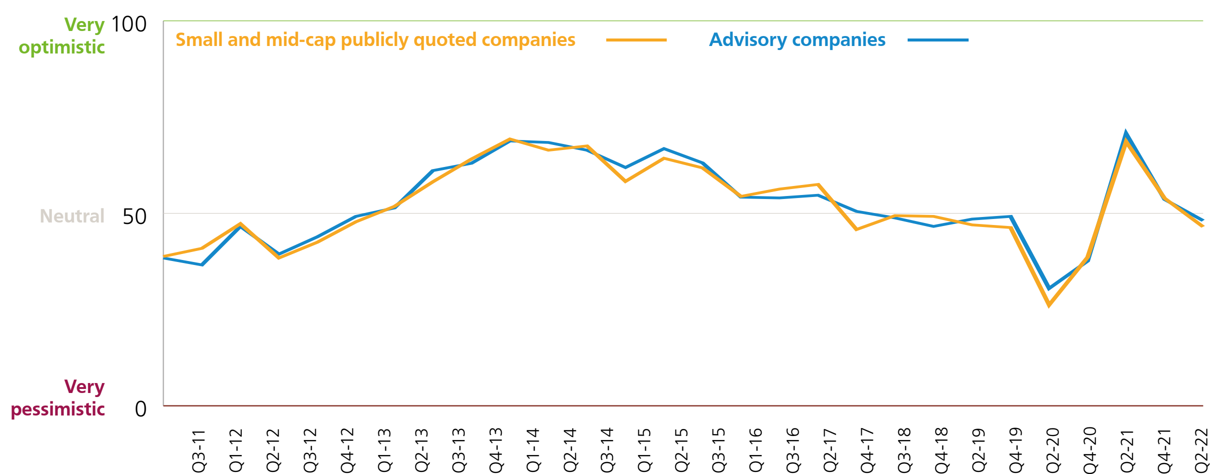
The results of the QCA/YouGov Sentiment Survey[15] collate the views of 107 UK-based small and mid-sized quoted companies and 21 advisory firms. The survey explored their sentiment towards the outlook of the economy and their businesses, as well as their access to capital.

The companies surveyed ranged in size from less than £25 million to more than £5 billion. Advisory respondents included corporate financiers, legal firms, institutional investors, accountancy firms, registrars, and others.

Economic and business outlook

UK economy outlook

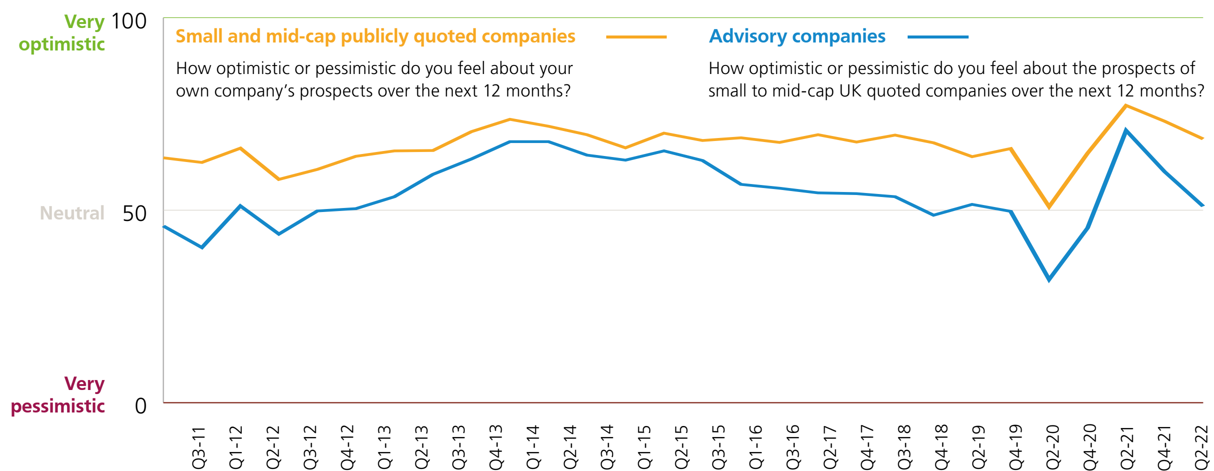
Figure 29 – Confidence in the UK economy has slipped significantly in the last 12 months



Commentary: Factors such as the war in Ukraine and macro-economic conditions, including rising inflation, supply chain issues, and increasing interest rates have contributed to the pessimistic outlook for the economy.

Business outlook

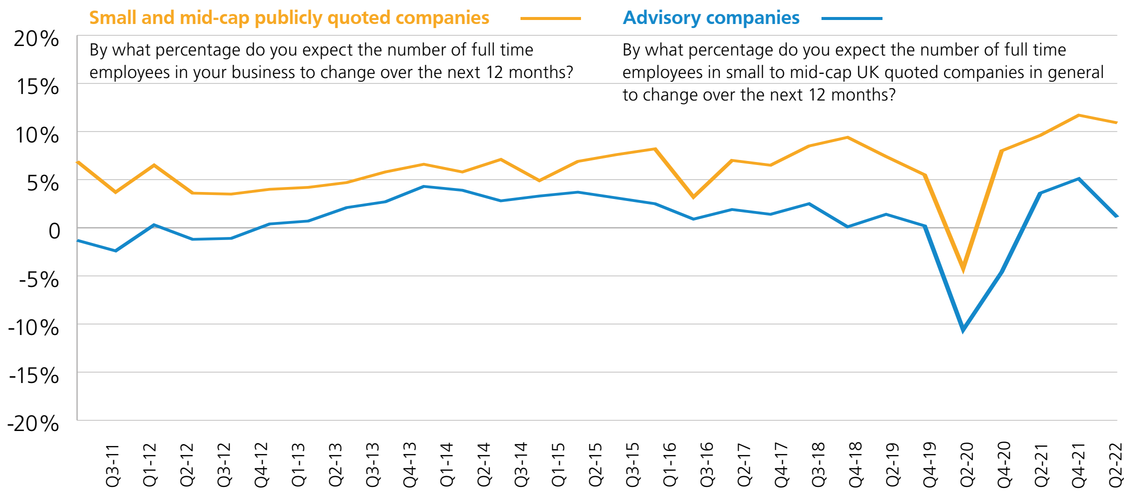
Figure 30 – There is a general feeling amongst small and mid-cap company directors that the performance of their own business will not be as positive as envisioned 6 or 12 months ago



[15] QCA/YouGov, 2022, Small and Mid-Cap Sentiment Survey, available at: https://bit.ly/3ysSowT

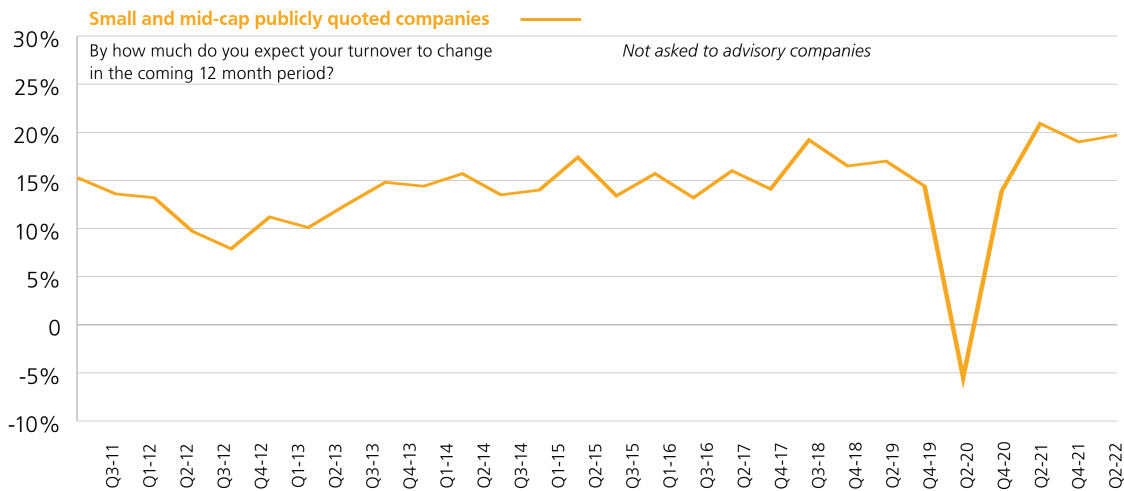
Job growth

Figure 31 – Small and mid-caps are expecting less employment growth compared to the previous survey, although at over 10% this is still fairly positive, particularly due to the negative results during the Covid-19 pandemic



Turnover expectations

Figure 32 – Company directors are expecting near record high turnover growth (at a similar level to when companies were expecting a post-Covid boost). However, it may be the case that this turnover growth is due to inflationary pressures and companies passing higher prices on to their customers

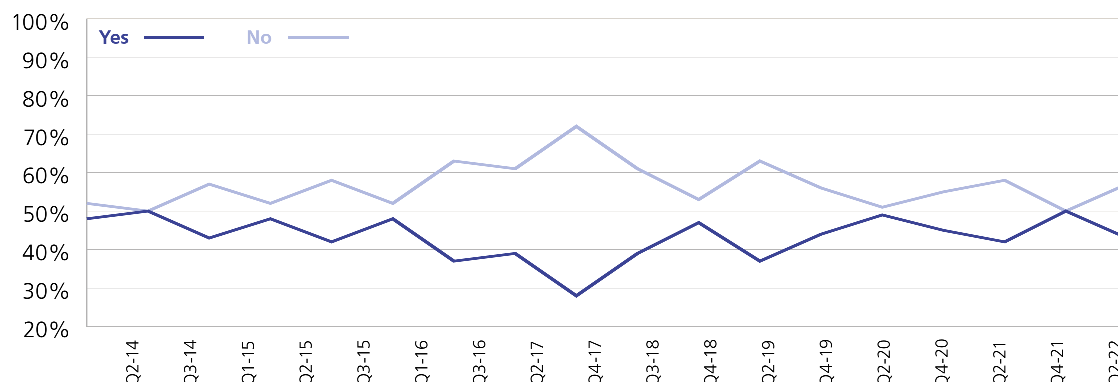


A reactive role is important, but neglect undermines the much more powerful, proactive role that public markets can play

Access to capital

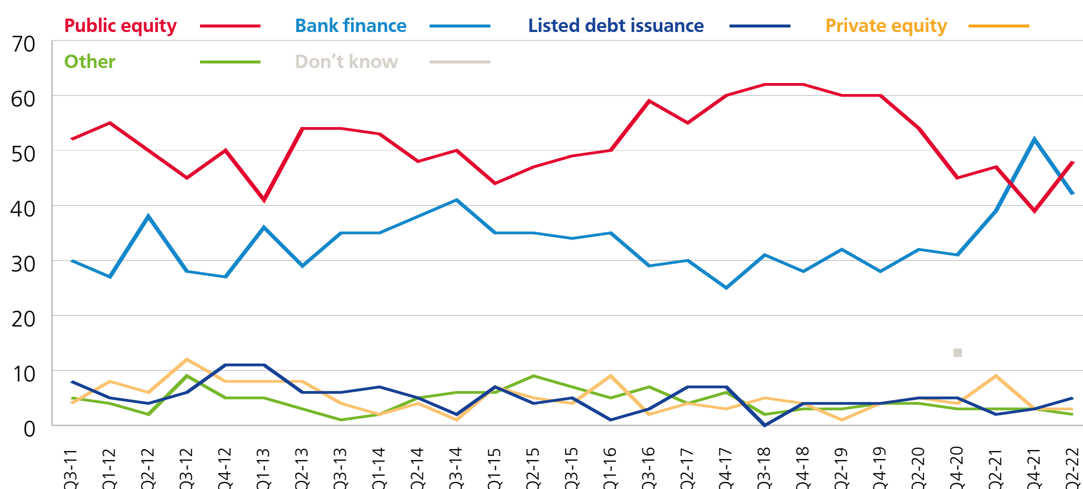
Plans to raise capital

Figure 33 – Companies were asked whether they plan to raise capital in the next 12-month period. A sizeable minority of companies envisage that they will seek external finance withing the next year.



Preferred routes to raising capital

Figure 34 – Companies were asked what their preferred way of raising capital would be, if they needed to do so in the next 12 months



Commentary: In a positive light, public equity returned as the preferred means of accessing external finance for companies. For the first time in the history of the survey, during H2 of 2021, companies indicated that bank finance was the preferred route to accessing capital. This was a concerning switch, having been on the decline for a few years. It is important that Government and regulators take note to ensure that public companies can make full and effective use of the public markets.

We need behavioural change to occur to encourage the greater use of our public markets by both companies and investors. A more venturist mindset from the providers of capital is needed to result in a greater supply of capital in the small and mid-cap space. The supply of capital has to become a greater focus of Government and the regulators.

Public markets operate at optimum level when there are many shareholders, not one, and when markets are open so that companies are able to access new investors and pools of capital. This helps companies move rapidly to regenerate balance sheets through the provision of permanent (equity) capital and not temporary (debt) capital. The public markets more than played their part alongside Government schemes during the Covid pandemic by providing fast access to capital and liquidity, helping to maintain jobs. A reactive role is important, but neglect undermines the much more powerful, proactive role that public markets can play.

3

3: Regulatory Reform, Change and Developments

This section focusses on the key regulatory changes and developments within the capital markets arena that potentially have a positive reformative outcome, aimed at changing the overall nature and structure of the markets. Rather than focussing on each individual consultation relevant to small and mid-caps, we focus on the more overarching reform agenda.

Since the release of Lord Hill's UK Listing Review call for evidence at the end of 2020, we have seen multiple developments on the regulatory reform agenda, potentially more than in any other period, and particularly in such a condensed period of time. The QCA has pro-actively engaged on all fronts throughout this period. To summarise our activities related to consultation responses in numbers over the 2021-2022 period to date, we have:

- Responded to 28 consultations
- Established 8 different working groups, comprising of over 70 individuals drawn across the QCA community including the QCA Board, Expert Groups and wider membership
- Held nearly 20 roundtables to discuss consultation responses, proposals and initiatives with Government ministers, civil servants, and senior figures from the regulators

3.1 Commentary on the overall state of regulatory reform, change and developments

Given the UK's new position outside of the EU, we have the unique opportunity to re-structure and re-invigorate our markets. The significant pace of change of political, social, economic and technological factors, as well as the fast-evolving nature of the global economy, means we need to modernise, and our markets must become more dynamic in terms of technological innovation and product marketing to avoid them becoming ossified. This is needed for the UK to cement its place as global financial centre; one that confidently displays flexibility, growth and innovation over the long-term. Short-term fixes will not work.

It is also imperative that market practitioners and professionals take a leading role in setting the parameters and framework for our markets.

Overall, the speed and efficiency demonstrated by the Government and regulator in regard to the reform agenda since the conclusion of the Listing Review in 2021 has been highly positive. Similarly, the general direction of travel has been promising too. Despite some developments to the contrary – most notably the BEIS proposals on audit and corporate governance reform which had serious potential to threaten growth as well as the number of companies retaining their listing/quotation – there appears to be a genuine desire amongst Government and regulators to make our markets more attractive and fit for the future. There is, for the first time in a long time, alignment between policymakers and market participants, including companies, investors and intermediaries; this is rare, and should not be taken for granted.

As highlighted in Section 1, in the last twenty years, the markets have declined in numbers by over 36%. There is genuine concern that the overall decline in market participants may be irreversible unless major change occurs now. This includes a serious threat to the critical mass of intermediaries with small-cap capital markets expertise, including within the accountancy and legal professions across the UK. If we are to attract more ex-UK companies to the market, then there needs to be knowledgeable and experienced local experts to advise these companies.

The developments we are witnessing in relation to the Prospectus Regulation, secondary capital raising, amendments to the Listing Rules, UK MiFID, and the debates around the structure of our markets have all been positively received by our community. However, the job is not yet done; we have a shared responsibility to ensure the future of our public equity markets. There is a significant amount of work needed to ensure that our policymakers make the bold and innovative decisions and seize the opportunities they are presented with to ensure the success of our public markets for the future.

However, and notwithstanding the above, it must be recognised that there has been a significant and ever-growing outflow of funds from the public equity arena in recent years and that without this reversing, nothing will change. We are currently witnessing the highest level of outflows in decades – nearly £6 billion has been pulled by investors in the first half of 2022[16]. In June alone, over £1 billion of funds left the market[17]. This means that regardless of what shape these reforms eventually take, Government and regulators must take a holistic approach to these reforms. To do this, they must complement the current supply-side initiatives with demand-side initiatives. Investors must be able to buy into any changes or developments that occur. Both long- and short-term capital is vitally important, as well as a wide range of investors; and we must seek to encourage and incentivise longer-term structural money. Failure to focus holistically on both supply- and demand-side reforms will continue the outpouring of funds from the public equity space, meaning that the desired outcomes of the current reforms will not be achieved.

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[16] Financial Times Adviser, August 2022, UK funds on track to post highest outflows in a decade, available at: https://bit.ly/3Cpq3sK

[17] Financial News, July 2022, UK equity fund outflows top £6.4 billion as bear market fears take hold, available at: https://bit.ly/3RTW69Y

HM Treasury

UK Prospectus Regime Review

The UK Prospectus Regime Review was published for consultation by HM Treasury on 1 July 2021, with a deadline of 24 September 2021. The consultation took forward the recommendations presented in Lord Hill's Listing Review, namely that the Government conducts a fundamental review of the UK's prospectus regime. The outcome to the consultation was published on 1 March 2022.

Commentary: The QCA engaged on multiple fronts with HM Treasury (HMT). In addition to the consultation response, we held several roundtable with HMT both during the consultation period and after.

Overall, the QCA broadly welcomes the outcome of HM Treasury's UK Prospectus Regime Review and appreciates the speed and efficiency of concluding the review. In particular, the QCA welcomes the separation of the regulation of admission of securities to trading and the regulation of public offers of securities, as well as the addition to the list of exemptions offers of securities which are or will be admitted to trading on certain Multilateral Trading Facilities (MTFs).

Furthermore, we welcome the intention to develop a mechanism that would allow admission documents that are published in accordance with the rules of MTFs (such as AIM or AQSE) to be treated as a type of prospectus.

HM Treasury's review of the prospectus regime, while understandably important, is very much a first step in the reform of the regime. Many of the changes that are yet to occur, including those that the QCA has advocated for, to ensure the prospectus regime is an agile and efficient one that is suitable for companies of all sizes, will be delegated to the FCA who will consult on further changes in due course.

The QCA's focus going forward will be on working with the FCA to ensure that the needs of small and mid-sized quoted companies are taken into account and proportionate rules are developed regarding the prospectus regime. In terms of next steps, we will have a particular focus on the FCA's new responsibilities including:

- Determining when a prospectus is required, including for secondary issuances by an existing listed company;
- Determining what a prospectus should contain, as well as the manner and timing of publication;
- Eliminating, or, at a minimum, limiting, the circumstances in which prospectuses must be reviewed and approved by the FCA prior to their publication;
- Determining whether to require a UK prospectus for a secondary listing or whether to rely on an overseas prospectus;
- Clarifying the link between forward-looking information and the raised threshold for liability; and
- Reviewing class test thresholds and the sponsor regime.

The QCA engaged on multiple fronts with HM Treasury (HMT). In addition to the consultation response, we held several roundtable with HMT both during the consultation period and after

UK Secondary Capital Raising Review

The UK Secondary Capital Raising Review was published for consultation by HM Treasury on 12 October 2021, with a deadline of 16 November 2021. The Review is being chaired by Mark Austin, Freshfields. The outcome of the Review was published on 19 July 2022.

Commentary: The QCA engaged with Mark Austin, the Chair of the Review, throughout the consultation period. In addition to our response to the consultation, we submitted an additional letter and held multiple roundtables to input into the Review.

Overall, we are very encouraged by the direction of travel of the review and the recommendations contained in the final report. We believe that the recommendations have the potential to make a highly positive impact on our markets to enable smaller quoted companies to raise capital cheaply and more efficiently. In particular, the recommendations we see as being especially positive include:

- Increasing the ability of companies to raise smaller amounts of funds quickly and cheaply by increasing the standard level for dis-application of pre-emption rights to 20%;
- Making fundraising structures quicker and cheaper by reducing the offer period for rights issues and open offers from 10 business days to 7 business days and reducing the notice period for shareholder meetings to 7 clear days;
- Involving retail investors in capital raisings by reducing prospectus requirements to encourage wider shareholder participation;
- Raising the current 20% threshold at which a prospectus should be required for an admission of shares to trading to at least 75% of the existing share capital;
- Elevating the priority of a ‘drive to digitisation’ by establishing a Digitisation Taskforce to facilitate innovation, stewardship and improved market infrastructure; and
- Improving the transparency and accountability of the Pre-Emption Group.

Whilst the Chancellor has accepted all the recommendations made to the Government, and both the FCA and Pre-Emption Group have issued statements welcoming the report, the work is set to continue. We look forward to working with the Government and regulators as they take the recommendations forward. In particular, the establishment of the Digitisation Taskforce is a crucial next step, and we will be sure to focus our efforts on the digitisation process going forward.

Wholesale Markets Review

The Wholesale Markets Review was published for consultation by HM Treasury on 1 July 2021, with a deadline of 24 September 2021. The Review set out to identify areas for reform that would capitalise on the UK’s new regulatory flexibility having left the EU.

The outcome to the consultation was published on 1 March 2022.

Commentary: The Government has reiterated its commitment to increasing companies’ ability to access primary and secondary markets, while preserving appropriate levels of regulation and investor protection and HM Treasury have been considering a proposal for an intermittent trading venue in more detail internally following the publication of the consultation response. The proposal would be for a new type of trading venue that would be open intermittently and would have altered regulatory requirements for companies.

The QCA has engaged with HM Treasury (HMT) and the FCA during these considerations and will continue to do so as they develop. However, and on the whole, the establishment of such a venue is not welcomed by our members. It has been made evident that there is limited desire for the creation of this type of trading venue and that efforts should be directed to making improvements to our current markets.

Future Regulatory Framework Review

The Future Regulatory Framework (FRF) Review was published for consultation by HM Treasury on 9 November 2021, with a deadline of 9 February 2022. The consultation made a series of proposals with a view to adapt the regulatory framework so it is fit for the future and reflects the UK's new position outside the EU. The outcome of the Review was published on 19 July 2022.

Commentary: Broadly, the QCA supported HM Treasury's FRF review, and in particular, the proposal to implement growth and international competitiveness objectives for the FCA. However, we stressed our belief that proportionality should also be hard-coded into the FCA's objectives. ***We do not consider that proportionality is sufficiently embedded into the regulators' principles or the Regulators' Code and nor do we believe it is applied consistently or rigorously.*** Adding a new proportionality objective would place it on a proper footing and ensure that the regulator is properly accountable and can be subjected to sufficient scrutiny. We are, therefore, disappointed that the outcome of the FRF Review rejected the notion to include a proportionality principle in the objectives of the regulator.

The Department for Business, Energy and Industrial Strategy (BEIS)

Audit and Corporate Governance Reform

The BEIS consultation on audit and corporate governance reform was published on 18 March 2021, with a deadline of 8 July 2021. The consultation was published following the three audit-related reviews (Sir John Kingman's review of the FRC, Sir Donald Brydon's review of the quality and effectiveness of audit, and the CMA's market study on statutory audit) and combined the 155 recommendations put forward within these reviews. The Government's response to the consultation was published on Tuesday 31 May 2022.

Commentary: Overall, the QCA welcomes the Government's re-think on many of the audit and corporate governance reform proposals. The QCA, its Expert Group members and wider membership committed a considerable amount of time and resources in responding to the consultation and engaging with the Government and FRC.

Public Interest Entity definition

In particular, we are pleased to see that the expansion of the scope of the definition of a Public Interest Entity (PIE) to AIM-quoted companies with a market capitalisation above €200 million has been dropped and replaced with a threshold of over 750 employees and £750 million turnover. The original proposal would have affected a significant number of small and mid-sized quoted companies, potentially constricting levels of growth, innovation, and job creation. The new threshold is more proportionate, and will help to ensure that only those with genuine public impact are included within the definition.

However, this again highlights our view made in several places in this report that it is too often the case that civil servants and regulators make decisions that are out of touch and inappropriate for the markets because they are not market practitioners and have no practical experience with the actual realities of our markets.

Reporting requirements

In a similar vein, it is encouraging to see that some of the requirements, such as in relation to the Resilience Statement, tackling fraud, and dividends and capital maintenance, will only apply to PIEs that meet the 750:750 test. Additionally, it is welcomed that the Government has amended, and diluted, many of the proposed reforms in response to the issues raised by consultation respondents.

We also welcome the Government's decision not to put a directors' statement regarding internal controls on a legislative footing, and instead, to invite the FRC to consult on strengthening the internal control provisions in the UK Corporate Governance Code to provide (on a comply or explain basis) for an explicit statement from the board.

ARGA's power and the UK Code

That being said, it is essential that ARGA adopts a proportionate regime when strengthening the provisions in the UK Code to ensure that the size constraints and burdens that will be placed on smaller quoted companies on the Main Market are understood and accounted for. As stated in the Government's response to the consultation, their initial predictions on costs were significantly underestimated; the FRC must ensure that a thorough impact assessment on costs and burdens is part of their consultation. This assessment must look at the small/midcap segment of the Main Market as a separate exercise.

Similarly, as ARGA takes on its increased responsibilities and powers, it must do so in a proportionate way. We are disappointed that the Government has decided not to add an additional regulatory principle setting out the need for proportionality stating that this is already included in general public law and in the Regulators' Code. We do not believe that this goes far enough and adding proportionality as a regulatory principle would put it on a proper footing and ensure that the regulator can be held accountable to this and be scrutinised on their performance against one of their own public objectives.

Financial Conduct Authority

Primary Markets Effectiveness Review

The Primary Markets Effectiveness Review aims to reduce barriers to companies listing in the UK and encourage private companies to consider listing at an earlier stage. The outcome of the Review was published on 2 December 2021, and a subsequent discussion paper, focussing on the structure of our markets and the sponsor regime, was published in May 2022 and closed for comment on 28 July 2022.

Commentary: The QCA broadly welcomes the FCA's policy response to the Primary Markets Effectiveness Review in that it will hopefully enhance the attractiveness of our markets and increase the number of companies seeking a listing. We are also encouraged by the timeliness of the FCA's response in taking forward the recommendations contained in Lord Hill's Listing Review.

However, we do not agree with the FCA's proposals to establish a single segment for equity shares in commercial companies. Under this regime, all companies would have to adhere to the same eligibility criteria, follow one set of mandatory continuing obligations and would be able to choose whether to opt into a second set of supplementary continuing obligations. We believe that this proposal significantly limits choice and will not correct the structural inefficiencies of our markets.

As advocated for in both our responses to the initial consultation paper (CP21/21) and the more recent discussion paper (DP22/2), we propose the creation of a new UK Listed Growth Market to operate alongside the current Premium List. Doing so will preserve the globally recognised high standards and reputation of the Premium Listing segment, while providing a more flexible and agile market for certain types of companies at an intermediate stage of their growth. We believe that this approach will provide sufficiently differentiated and compelling choice for companies and investors.

We do not agree with the FCA's proposals to establish a single segment for equity shares in commercial companies… We believe that this proposal significantly limits choice and will not correct the structural inefficiencies of our markets

UK MiFID

In April 2021, the FCA published a consultation paper on changes to UK MiFID's conduct and organisational requirements. The consultation proposed changes to two key areas: research and best execution. The Policy Statement outlining the changes was published on 30 November 2021.

Commentary: The QCA welcomes the changes outlined in the FCA's Policy Statement and believe they represent a positive step towards improving the UK's markets for small and mid-sized quoted companies. In particular, the research exemption for small and mid-caps with a market capitalisation below £200 million from the inducement rules has the potential to increase the visibility of small and mid-caps through an increased depth and breadth of research by allowing research on companies to be provided by brokers to asset managers on a bundled basis. However, much of the damage has already been done and small and mid-caps are still impacted by the impacts of the regulation. For instance, brokers often still charge institutions for research and do not typically make research available to retail distribution platforms.

Financial Reporting Council

Transition to the Audit, Reporting and Governance Authority (ARGA)

Commentary: Following the publication of the Government's response to the BEIS audit and corporate governance reform consultation, the FRC's transition to ARGA will pick up pace. The FRC has already made progress in its transition to ARGA and continues to expand its capacity. The new regulator will be placed on a statutory footing, will be governed by key objectives, and will have a clear remit from Government. The Government's package of reforms will give ARGA a range of statutory responsibilities and powers that the FRC does not have. These include formalised responsibility for overseeing the accounting and actuarial professions, a stronger role in auditor registration, and new powers to tackle breaches of company directors' duties relating to corporate reporting and audit.

As stated above, we will continue to stress the need for proportionality as the regulator undergoes its transition. Proportionality must be at the heart of any regulatory developments that are made so that the costs and benefits of reform are balanced, and smaller companies are not disproportionately impacted. It is imperative that better policy decisions are made by ensuring that those with relevant experience as market practitioners are appointed. As stated above retrospectively adjusting disproportionate law and policy is a waste of time and resources and is a drain on the UK economy, rendering markets unattractive for significant periods of time, during which companies may make irreversible decisions.

4

4. Solutions

In this section of the QCA's State of the Small and Mid-cap Sector Report, we propose several high-level solutions to improve and enhance our markets so that they are not only fit for purpose but also inspire future companies and investors to utilise them, so that wider society can reap the benefits. We believe a holistic approach is essential; one that focusses on both supply and demand-side initiatives.

4.1 Supply-side solutions

Following Lord Hill's UK Listing Review (and as detailed above), Government and FCA are working on several initiatives that have a focus on enhancing the supply-side elements of our markets. These initiatives focus on increasing the attractiveness of our markets to encourage more companies to seek a listing and prevent companies from leaving our markets. We welcome many of these developments and continue to work closely with Government and the regulator as they take these initiatives forward. However, we have several proposals to put forward.

Establishing a new UK Listed Growth Market

In terms of primary markets – the issuance of new shares by quoted companies, and specifically through conducting an IPO – there are structural inefficiencies that are preventing companies coming to market and remaining on them. The provision of a growth-oriented listing option, through the establishment of a new UK Listed Growth Market, would help to address these structural inefficiencies.

In our response[18] to the FCA's Discussion Paper on the Primary Markets Effectiveness Review (DP22/2[19]), we proposed the establishment of such a market, stating that the provision of choice and the removal of complexity are the central factors in making positive change. This market would operate alongside the UK Listed Premium Market and would reflect the growth-oriented nature of the companies listed there, offering a more proportionate, flexible, and dynamic listing alternative for high-growth innovative companies. The creation of a UK Listed Growth Market will help to reverse the deeply embedded trend of shrinking UK markets and ensure that the UK is the destination where

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[18] QCA response to FCA – Primary Markets Effectiveness Review, available at: https://bit.ly/3CNRspr
[19] FCA, May 2022, Primary Markets Effectiveness Review: Feedback to the discussion of the purpose of the listing regime and further discussion, Discussion Paper (DP22/2), available at: https://bit.ly/3CNV62I

companies can start, grow, scale up and thrive so that our investors have access to diverse and wide-ranging opportunities that help support the real economy and the UK's economic growth.

Enhancing secondary capital raising

The QCA welcomed the recommendations included in the final report by Mark Austin on the UK Secondary Capital Raising Review[20]. In particular, we welcome the following recommendations:

- Increasing the ability of companies to raise smaller amounts of funds by increasing the standard level of disapplication of pre-emption rights to 20%.
- Making fundraising structures quicker and cheaper by reducing the offer period for rights issues and open offers from 10 business days to 7 business days and reducing the notice period for shareholder meetings to 7 clear days.
- Raising the current 20% threshold at which a prospectus should be required for an admission of shares to trading to at least 75% of the existing share capital.
- Involving retail investors in capital raisings by reducing prospectus requirements to encourage wider shareholder participation.
- Elevating the priority of a 'drive to digitisation' by establishing a Digitisation Taskforce to facilitate innovation, stewardship, and improved market infrastructure.
- Improving the transparency and accountability of the Pre-Emption Group.

We now encourage Government and the regulators to work to implement these recommendations in a timely and efficient manner.

Prospectus reform

In a similar vein to the UK Secondary Capital Raising Review above, the QCA broadly welcomes the outcome of HM Treasury's UK Prospectus Regime Review in seeking to improve the speed and efficiency of capital raising and facilitating wider participation in the ownership of public companies. The prospectus regime, inherited from the EU, has long been a serious impediment to companies that are seeking growth finance. The time-consuming and costly processes involved in producing a prospectus are a significant and disproportionate burden for small and mid-sized quoted companies.

Going forward, and as the FCA is handed greater powers to facilitate a review of, and eventually make changes to, the prospectus regime, we encourage the FCA to:

- Develop a mechanism that would allow admission documents that are published in accordance with the rules of MTFs (such as AIM or AQSE) to be treated as a type of prospectus.
- Add to the list of exemptions offers of securities which are or will be admitted to trading on certain MTFs.
- Reduce the circumstances whereby a prospectus is required, such as for secondary issuances by an existing listed company (in line with the recommendation in the UK SCRR).
- Limit what a prospectus should contain.
- Eliminate the circumstances in which prospectuses must be reviewed and approved by the FCA prior to their publication.
- Improve the regime for private placements, which often act as a precursor for companies to go public.
- Remove or amend the financial promotion rules.

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[20] UK Secondary Capital Raising Review, July 2022, available at: https://bit.ly/3fWvOGI

4.2 Demand-side solutions

In addition to the supply-side solutions proposed above, Government and the regulator must seek to couple these reforms and develop demand-side solutions to facilitate an increase in the supply of capital from a range of investors with varied time horizons in our public markets. Failure to do so will not overturn the outflow of funds from the public equity arena that has occurred in recent years.

The outflow of investment has been very well documented, with multiple commentators providing thoughts on why there has been such a significant outpouring. Most recently, the Russia-Ukraine war, surging inflation and rising interest rates are often cited as key reasons, with the Covid-19 pandemic and Brexit as earlier events that have contributed to the withdrawal of investment capital. In 2021, for instance, outflows topped £4.4 billion, with total outflows amounting to over £21 billion for UK equity funds since 2016[21]. Small and mid-caps have been hit particularly hard as they are often seen as higher risk during an economic downturn. This sector, therefore, often accounts for a significant portion of the outflow from UK equities.

There is an urgent need to identify new pools of capital to invest directly and indirectly in small and mid-caps. Positive change must occur to release capital from a range of different investors into the small and mid-cap public equity space.

Reforming Solvency II

Solvency II – an EU directive, retained in UK law, that regulates the insurance industry and outlines how much capital a firm must hold – has significantly prevented the release of capital into UK companies. HM Treasury's consultation in 2022 is a first step in the review of the regime and certain proposals around risk margins, increasing investment flexibility and reducing reporting and administrative burdens have the potential to unlock investments. In particular, a reduction in the capital requirement thresholds, and providing greater flexibility in terms of where insurers can invest their assets, has the potential to result in a material increase in long-term investments, including small and mid-caps.

The Government must ensure that the right balance is achieved by removing the adverse consequences of Solvency II while maintaining an appropriate degree of policyholder protection. If this can be achieved, this could result in increased competitiveness and reduced costs for insurance firms, whilst our markets and the UK economy as a whole benefit from an injection of long-term capital.

Reforming pension fund investment

Defined contribution pension schemes are one of the UK's largest reserves of capital. If this could be unlocked, it could have a material and deep-seated impact if invested into small and mid-caps, the UK's engines of growth, as well as giving pension savers a stake in the entrepreneurial future of the UK. Pension funds could be significantly transformative to the UK economy. They operate and plan on a longer-term basis and can unlock vast pools of institutional capital that would produce benefits for both companies and the pension holders themselves.

However, in order for their transformative potential to become a reality, regulatory change is needed to address the existing regime and enable pension money to be used to its full effect. Government and the FCA must address this and allow pension funds to access public markets more efficiently, and in particular, unleash capital to be invested in small and mid-caps who may find it more difficult to attract institutional investment.

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[21] Financial Times, January 2022, Investors continue to shun UK equity funds, available at: https://on.ft.com/3Ml67vL

Enhancing liquidity

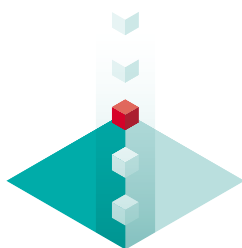
Liquidity – the ease with which shares of a stock can be bought and sold without substantially impacting the stock price – is one of the single most important features of a healthy, vibrant and thriving stock market. In recent years, liquidity has been a central issue for small and mid-cap stocks, coming under pressure for a variety of reasons.

The suspension of the trading of the Woodford Equity Income Fund in June 2019 significantly worsened the situation, with widespread consequences still being felt now and are set to continue for some time. The collapse has adversely impacted the volume of trading in the shares of small and mid-sized quoted companies. This has occurred as institutions have responded to the alarmist responses of their clients by taking a wary approach when it comes to liquidity risk, resulting in an increase in the size of the smallest company that a small-cap fund manager would consider when looking to add a new position to a portfolio (minimum market capitalisation cut off). Some consider this minimum market capitalisation cut off point to be up to £400 million.

A further consequence of the issues highlighted by the Woodford debacle has been that internal and external compliance, risk and control functions have become much more focussed on liquidity. This overly cautious approach has been forcing investors to reduce exposure to less liquid stocks. In addition to this, the FCA has issued, on a piecemeal basis, letters to Authorised Fund Managers in relation to good practice for effective liquidity management[22]. This letter was perceived by recipients to be generally unhelpful due to its apparent one-size-fits-all approach and its design which seemingly intends to deflect blame from the regulator in the event of further liquidity issues in open-ended funds – as well as not providing any clear guidance to fund managers on what was appropriate specifically in relation to smaller listed growth stocks. This lack of clarity has resulted in an increasing tendency amongst fund managers to act with increasing caution.

As a result of the above, we would like to put forward certain high-level proposals/solutions that would help to counter the liquidity issues raised. Namely, that:

- The FCA clarifies its intentions and position on less liquid stocks;
- Tax breaks are extended to encourage investment in small-cap stocks; and
- A minimum commission rate for market makers could also be considered. This would make it more attractive for market makers to make markets for certain stocks. This has the potential to narrow bid-offer spreads, improve liquidity, and ultimately, lower the cost of capital, to the benefit of the smaller quoted company space. Thoughts around how this could work in practice would need to be given further consideration.



We welcomed the FCA's research exemption for smaller quoted companies with a market capitalisation below £200 million from the unbundling rules

[22] Nick Miller, Head of Asset Management, FCA, Letter on Effective liquidity management: good practice for Authorised Fund Managers, 4 November 2019 https://bit.ly/3SPeeD4

Increasing the quality and quantity of research

The ability of investors to access and invest in growing companies is predicated on the visibility of a company and on investors being able to develop an understanding of a company's business. Independent research on small and mid-sized quoted companies is essential for increasing visibility and stimulating trading in their shares. Research eases price discovery and enhances liquidity, which in turn reduces the cost of capital for companies and encourages their growth.

The nature of small and mid-sized quoted companies dictates that research coverage is the only realistic and affordable means by which they can increase their visibility to the market. MiFID II has resulted in less research being produced and fewer brokers participating in the small-cap segment of the market, which has led to lower liquidity, greater share price volatility and higher-bid offer spreads. This has resulted in increased costs associated with raising finance coupled with reduced institutional access.

Investors must be able to see the companies that they can invest in. We welcomed the FCA's research exemption for smaller quoted companies with a market capitalisation below £200 million from the unbundling rules. However, the current threshold does not accurately reflect the current realities or the growth company ecosystem. The threshold fails to capture many small and mid-sized quoted companies, as well as failing to reflect the developments within, and the maturing of, the growth company ecosystem. As a result, many small and mid-sized quoted companies will find that their recent growth and success inadvertently pushes them outside the limits of the proposed threshold whilst they are still small and in a developmental phase.

In light of this, we suggest that the threshold is increased to £1 billion. We also encourage Government and the FCA to consider further means of enhancing the research produced on small and mid-caps.

There is also a dearth of research analysts covering technology and other innovative stocks. This is often highlighted by the investment banks as an example as to why the US has a significant advantage over the UK. And yet it is the investment banks that have the resources to address this by employing these analysts in London. This is a chicken and egg situation, but Government and market operators must find a way to crack this impediment through soft politics, incentives and other measures.

4.3 Proportionality

Underpinning both supply-side and demand-side reform should be the principle of proportionality.

Proportionality

A major impediment to the effective functioning and growth of the UK's markets has been a lack of proportionality and a one-size-fits-all approach to the development and implementation of regulation. This means that regulation is usually developed with the largest companies in mind but applied across the board, disproportionately impacting smaller companies.

It is often said that proportionality has been considered and flexibilities provided by giving companies the choice to 'comply or explain'. However, what this model does is normalise and socialise an 'optimum-level' benchmark that is unachievable for many (whilst experiencing disproportionate costs and burdens) and, when companies cannot reach this benchmark, it is looked on poorly by other market participants, such as proxy advisors and certain investors.

This has been a deep and longstanding concern of the small and mid-cap community. To correct this, we propose that the principle of proportionality should be added to the operating objectives of our regulators. There has often been an inability amongst our regulators to understand the nature of the companies that operate on the market and the impact that regulation has on them. The fact that many individuals within our regulators have never been market practitioners is concerning and needs to be changed.

Introducing a proportionality objective would give market participants increased confidence that the markets are suitable for their needs. The regulators should have a duty to conduct any impact analysis of public markets by looking at the impact on the FTSE 100 separately from the rest of the market. In this way, the real impact on smaller companies will be plain for all to see. Continuing impact assessments on a market-wide basis is inefficient and costly, causing retrospective adjustment to legislation, regulation and the business models of intermediaries. Some of the changes are irreversible, leading to permanent structural damage.

We disagree that the principle of proportionality is already sufficiently embedded within the regulators' statutory principles and the Regulators' Code. It is the view of our membership that it is not applied appropriately or consistently. Adding proportionality to the regulators' objectives would place it on a proper footing and ensure they are genuinely accountable and can be subjected to sufficient scrutiny

The proportionality objective is simple; it should ensure that any burden imposed as a result of the implementation of new regulation should be proportionate to the benefits. The objective should also go further than this to take account of the relative burden of regulation on different market participants, taking into consideration size and complexity.

As such, we propose that an industry representative (or representatives) is appointed to spearhead the reforms and help to achieve real impact and in quick order.

4.4 A new approach to reform and the civil service and regulators

A new approach to reform

In this paper, we have discussed and provided commentary on multiple pieces of regulatory reform. Broadly, we welcome these developments in their own right. However, the multitude of reviews from so many different bodies inherently adds layers of complexity to the process and lengthens the time it takes to achieve consensus, resulting in a group think approach that fails to achieve step change. The decision-making process is not nimble enough and making bold change is too cumbersome.

We recognise that the reform agenda is far-reaching and will involve substantial input and effort from many. However, we believe that the reform process would benefit greatly from having an independent, overarching figurehead responsible for the overall vision and direction of travel for the reforms.

As such, we propose that an industry representative (or representatives) is appointed to spearhead the reforms and help to achieve real impact and in quick order.

Those appointed must have sufficient experience as a market practitioner and capable of exercising judgements in a proportionate manner. Small and mid-cap professionals must have a significant input for there to be a chance of changing the system positively for the future.

Moreover, and going forward, any future regulatory change or proposed developments should take a proportionate approach, including in relation to conducting a cost-benefit/impact analysis.

We welcome the outcome of the Future Regulatory Framework Review regarding the requirement for the FCA to publish a statement of policy on their approach to cost-benefit analysis (CBA) in that it will help to ensure that the development and implementation of an initiative is properly scrutinised. However, any CBA undertaken must take a targeted, segmented approach. Given that the current weighting of the market where the largest 100 companies on the UK's markets account for 85% of total market capitalisation means that any regulation that creates strong regulatory safeguards will be seen as a net benefit for the market overall. However, the impact of the same regulation on growth companies can often be seriously detrimental to the UK's growth prospects. Therefore, any cost benefit analysis should, by law, be conducted on a segmented basis whereby the FTSE 100 companies are looked at separately from the rest of the market. In this way, the impact on smaller companies will be more evident and regulation can be made more appropriate and proportionate, limiting the need to make retrospective adjustments that are often time-consuming and costly.

A new approach to the civil service and regulators

A central issue that has been evident for some time is the absence of experienced market practitioners and professionals within the civil service and regulators. This has often resulted in poor, inappropriate and disproportionate decision-making due to their lack of understanding of the intricacies of our markets, experience that can only be obtained through have direct involvement within industry. There needs to be a drive towards encouraging greater numbers of current and former market participants into the civil service and regulators.

As such, we propose that the civil service and regulators adopt an approach like that of the Takeover Panel whereby industry figures are appointed on secondment.

Appointing market practitioners/professionals and allowing them to work on setting the parameters of rulebooks and market frameworks will help to ensure that regulatory developments and initiatives are appropriate, proportionate and make a meaningful and informed difference to our markets.

We urge the Government and regulators to take heed of the deeply concerning trends highlighted in this report by engaging further on the solutions we propose.

Now is the time to drive through real change so that our markets can thrive in the future, helping to ensure that we continue to celebrate the positive social and economic impact of our markets.

About the QCA

We are the Quoted Companies Alliance. We bring small and mid-sized quoted companies together to build one voice to help create an environment where these businesses can grow and deliver sustainable long-term benefits for investors and wider society.

The value of small and mid-sized quoted companies is vast. There are around 1,080 small and mid-sized quoted companies in the UK, representing 91% of all quoted companies. They employ approximately 2.1 million people and contribute over £25 billion in annual taxes.

We believe that our members have huge potential, but they need a public market environment conducive to growth to allow them to attain it. We enable this environment by influencing policy and regulation, informing our members through surveys, research and guides and creating interaction through workshops, webinars, networking events and exclusive meetings.

Our members are quoted on the Main Market, AIM and the Aquis Stock Exchange. Informed by our seven Expert Groups, we campaign to ensure that regulation is proportionate and encourages growth, whilst maintaining the necessary protections for investors.

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QUOTED COMPANIES ALLIANCE

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