Financing the real economy - Quoted Companies Alliance submission to the Business and Trade Select Committee

Introduction to the Quoted Companies Alliance (QCA)

1. The QCA advocates on behalf of small and mid-cap companies across the UK. We have close to 300 members representing the UK's 1,000+ small and mid-sized quoted companies and the firms that advise them. Collectively, these companies represent around 80% of companies on the UK's public markets.
2. Our members' industries range from fintech, biopharmaceuticals and energy to the food and retail sectors, and are quoted on the Main Market, AIM and the Aquis Stock Exchange.
3. Being a quoted, or listed, company provides a range of benefits for businesses, including increased exposure to a greater range of investors, access to a continuous source of equity and the corresponding possibility of sustainably growing the company.
4. Small and mid-sized quoted companies are a vital source of job creation and tax revenue. For example, one-third of listed UK companies with a market value of more than £2 billion in 2024 were once a smaller company in the past 20 years and subsequently have more than doubled in value in real terms. In 2023, companies on AIM provided £68 billion Gross Value Added (GVA) to UK GDP; and contributed £5.4 billion in corporation tax.
5. We recognise that this inquiry covers a broad spectrum and have therefore limited our response to our key areas of concern and expertise. We are happy to be contacted about our submission at any time, to provide further evidence or research, and would be pleased to be called to provide oral evidence.

Is British investment too low and why?

Why has UK investment lagged so far behind peers for decades?

6. UK investment has lagged peers for decades due to a range of factors – notably, continuous policy changes, a complex regulatory environment, underinvestment in public infrastructure and poor management practices further exacerbate this issue, creating barriers and uncertainty that discourage long-term investments. Often, investors are either unaware of the potential investment opportunities, or simply unable to access the requisite level of information to make a well-informed investment decision in smaller quoted companies. In this event, smaller quoted companies frequently find themselves outside of the scope of investors' decision-making.
7. Although the UK remains one of the world's leading capital markets centres, the number of domestic and international companies using public markets in the UK is falling – a trend not unique to the UK. IPOs have been stubbornly low and delistings consistent. Data from 2024, shows there had been a 24% drop in the average number of companies on AIM over the previous three years compared to the 20-year average. Delistings and a corresponding shrinking in size of the UK stock market directly harms the UK's competitiveness and status as a leading global financial hub. A shrinking stock market is also consequential for UK growth, productivity, employment, tax revenue and individual's savings.

8. The decline in UK pension funds' exposure to domestic equities is well documented and a contributory factor towards to declining investment in UK companies and their subsequent delisting from the London Stock Exchange. For example, 2023 data shows that domestic pension funds have reduced their allocation to UK equities from 53% to 6% over a 25 year period.

9. Another significant area of development is the rise of passive investing. From 2013 to 2023 there has been a 9% increase in UK assets under management held passively with 32% of assets now held in passive funds. While it could be argued that outflows from UK equity funds are offset by the rise of passive strategies, this has little to no impact on the UK's smaller high growth companies as these companies have market capitalisations that are too small to enter into the main UK focused indices that track the funds, leaving smaller companies excluded from a vital source of potential funding. While there may be sound economic reasons for investing in passive tracker funds due to their relatively low cost, they contribute little to UK growth and tax revenues, nor aid fundraising activities (IPOs, or further issues). Their continued prominence, and the extent to which they draw investors away from actively managed funds, will have funding implications for UK smaller companies, and capital markets more broadly for years to come.

10. Meanwhile a point often overlooked but is important to investors, is investment research. The lack of investment research in the UK, both in terms of quantity and quality, is a contributory factor in the decline of our markets in recent years. The provision of quality investment research is important for all companies in helping to lower the costs of raising capital and stimulating liquidity. However, it is especially important for smaller quoted companies whose nature dictates that research coverage is one of the only realistic and affordable means by which they can increase their visibility to the market.

11. Making the UK more attractive to investors is vital to generating inflows of global capital and subsequently stimulating economic and business growth. The Government must therefore look to prioritise strategic reform to boost the UK's investment performance as the fundamental driver of its economic and fiscal performance.

The seekers of capital

What challenges do UK businesses face in accessing growth finance—especially at the scale-up stage?

12. Ensuring there is sufficient access to scale-up finance for smaller growth companies, and broader investment in UK equities is a vital component to overturning the current delisting trend. The UK must provide a home for companies looking to raise capital. That is true both to ensure we support the growth and resilience of the UK's domestic economy but also for our standing as a global financial centre, where we must be able to service the needs of international companies looking for a competitive market venue. The QCA has been working to help unlock more domestic capital investment across the UK – ensuring that initiatives like the Mansion House Accord and British Business Bank includes AIM companies.

13. Low levels of liquidity for smaller company stocks is another barrier to growth on the UK's capital markets. Liquidity is an essential feature of a well-functioning market as it aids price discovery and valuations, and reduces the cost of raising capital for companies. For example, in 2024 just 5% of AIM companies traded more than £1m a

day; almost three quarters traded less than £100,000 a day; and half of AIM stocks had less than 10 trades a day.

14. Alongside the issues raised in the previous question, liquidity constraints placed on smaller situation has further exacerbated this situation. The collapse of the Woodford Equity Income Fund in 2019 and the FCA's response to it in the form of liquidity constraints has generated apprehension and reluctance among the asset management industry to invest in smaller, less liquid stocks. The FCA's letter on effective liquidity management in 2019 and the liquidity management multi-firm review in 2023 both adopted a one-size-fits-all approach to the issue and failed to consider some of the unintended consequences of its response. For investment funds, the ability to allocate into AIM and FTSE small cap with a view to long-term capital growth is hindered by liquidity metrics that are geared towards large cap companies. These impose liquidity constraints that deter fund managers from investing in sub-£100 million market cap companies.

Are public markets fit for purpose for UK companies seeking to list?

15. UK public markets are not universally fit for purpose, as evidenced by declining company listings and an increasing trend of companies staying private longer. Delistings and a corresponding shrinking in size of the UK stock market directly harms the UK's competitiveness and status as a leading global financial hub. A shrinking stock market is also consequential for UK growth, productivity, employment, tax revenue and individual's savings.

16. The ever-growing regulatory and reporting requirements, as well as increased complexity and cost of compliance, are a significant burden for quoted companies and is a contributory factor to the decline in number of companies on the UK's public markets in recent years. From 2018/19 – 2023/24, AIM company annual reports have increased overall, with a 23% rise in word count during that period. As such, the average public company annual report and accounts has grown 31% in five years to 98,000 words.

17. Meanwhile, the significant surge in audit fees places financial strain on small and mid-cap companies, diverting essential funds from areas like R&D which hinders growth. This cost increase acts as a deterrent for companies eyeing public listings as it complicates entry into public markets. Audit-related challenges further dissuade companies, impacting their market aspirations. Small and mid-cap companies, focused on compliance, face challenges in securing auditors during the tender process, leading to delayed financial reporting. Failure to secure an auditor raises investor concerns about transparency and regulatory adherence, diminishing trust and hindering capital attraction. Limited availability of auditors, especially with specific sector knowledge, contributes to the de-equitisation crisis, reducing the number of companies on public markets. The QCA believes the audit process should be streamlined to promote efficiency.

18. Given their lesser resource, the extra length and associated complexity is harder to manage than at a large company. Moreover, the demands of these requirements result in companies, and the directors that manage them, having reduced time and capacity to focus on their business's growth.

19. It is important to note that recent Listing reforms to the London Stock Exchange's Main Market are a positive development, while the recent AIM discussion paper on reforms to that market are also welcome. Nevertheless, alongside departures resulting from takeovers of AIM companies, and issues around cost and regulatory friction, lack of investor appetite is a significant factor driving companies to exit the market. In some cases, that lack of appetite may be attributable to the perceived unattractiveness of the issuer as an investment proposition. However, in many cases, it appears to simply reflect a general lack of interest in AIM stocks (in smaller and medium size companies in particular) by the investment community. We believe that this can only be addressed by a combination of "supply side" reforms through vehicles such as the Mansion House Accord, British Business Bank, and ISA reforms; fiscal incentives; and regulatory reforms to "right-size" the cost and risk profile of the market.

20. While the UK stock market faces a range of challenges, it is still important to highlight that globally, UK smaller companies are competitive with London possessing a preeminent growth market in AIM. For example, in 2024, AIM was responsible for 54% of all European growth market capital raised over the previous 5 years, while in 2024 alone, US companies AOTI and MicroSalt opted for quoting on AIM.

How do UK financial products compare to international peers like the US?

21. Globally, the UK's capital markets face competition from a range of international competitors with a number of rival markets emerging in South East Asia, and not least from the US and EU.

22. The US has a clear global competitive advantage, with a large domestic market and deep pools of capital. However, the perceived boon for UK companies listing in the US often fails to materialise and given the UK capital markets' relative strength, the flow of UK companies moving across the Atlantic is by no means inevitable. Meanwhile, the EU has undertaken an extensive capital markets reform agenda. This culminated in the European Council's adoption of the Listing Act in October 2024.

23. In the context of proposed reforms to the ISA regime and the Government's retail campaign, it is important to note that a number of the UK's international peers offer an ISA/ISA-like product that offer tax breaks for investment in domestic equities including: France: PEA, Japan: NISA, USA: IRA, and Italy: PIR. New Financial research from 2023 highlights that were the Government to create a UK ISA by implementing a 50% minimum threshold for investment in British equities in order to qualify for tax breaks under, the ISA wrapper would result in an additional £7bn of annual investment flows into UK equities.

What support do businesses need to become investment-ready, and how can government or industry provide it?

24. The Government has correctly identified financial services as a key sector in the UK economy and fundamental to its future growth prospects, and we share its view that within financial services, capital markets are a priority growth opportunity for the UK.

25. We commend the Treasury and FCA for its work on the capital markets reform agenda and welcome the changes to the Listing regime, upcoming prospectus reforms and the proposed PISCES platform. These modifications to the UK's capital market infrastructure should increase the attractiveness of listing in the UK, improve the international competitiveness of our public markets, and encourage more companies to list and remain listed here.

26. Increasing investment in UK publicly listed companies must be a priority for this Government, and in particular, for smaller companies. Compared to their larger counterparts, smaller companies' exposure to investors is more limited and their funding needs more acute, yet their growth potential is vast.

27. There are a number of areas the Government should target to unlock barriers to growth in capital markets, and particularly for smaller companies including: as a minimum, maintaining business relief for AIM and Aquis stocks at its current level; directing pension fund investment into smaller companies; the creation of a UK ISA; and building an Investment Research Platform.

Government strategy and the role of ministers

How are UK policy institutions like the British Business Bank, National Wealth Fund and DBT working to 'crowd in' private finance?

28. We are fully supportive of the Government's efforts to harness the UK's business potential and welcome recent moves to bring in more investment. However, there is concern that quoted companies, like our members, are all too often overlooked in Government policy – making the current regulatory landscape difficult for small and mid-caps to operate. This needs addressing urgently if quoted companies are to grow and thrive in the UK markets.

29. It is our strong belief that the remit of the British Business Bank urgently needs to be extended to support public companies, as well as private. The public markets are an essential tool that offer choice to the UK's entrepreneurial companies, as well as powering competitiveness. The British Business Bank should be deployed to address funding gaps here, just as it has been asked to do in the private equity and venture capital world. Furthermore, the QCA believes the Government should proceed with the Mansion House Accord reforms and explore changes to pension tax reliefs to direct investment in UK smaller companies.