REVITALISING THE UK'S CAPITAL MARKETS

Concerns about the competitiveness of the UK's capital markets have returned after the initial post-pandemic bounce. Criticaleye's **Jacob Ambrose Willson** explores what is being done to drive the kind of reforms that will ensure London remains attractive for both investors and management teams

Headline figures for IPO activity on the UK Main Market and AIM over the first half of 2023 make for somewhat grim reading. The total number of deals dropped by 31 percent compared to the same period of 2022, with 18 issuers raising a total of £593 million through London's markets.

Further inspection on a quarterly basis reveals an even bleaker opening to the year, with UK IPO proceeds in Q1 80 percent lower than in 2022 and a remarkable 99 percent lower than the record levels experienced in Q1 2021.

The situation was perhaps encapsulated by the recent decision of soda ash >

producer We Soda to scrap plans to list on the London Stock Exchange just weeks after announcing the move, citing an 'extremely cautious' investor environment. The float was expected to raise £600 million via the London market.

This slowing to a drip of fresh listing activity on the UK public markets can be largely attributed to the global economic downturn and other macro headwinds. But there seems to be a lot more to unpack around London and its ongoing reputation as a world-leading centre of finance, particularly given other recent high-profile snubs and postponed listings.

Charlie Walker, Head of Equity & Fixed Income Primary Markets at London Stock Exchange Group, thinks that the global context remains an important factor. "If we go back to 2021, the IPO market was very busy and London had the largest IPO market in the world outside of the US and greater China," he recalls.

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>
> Grant Humphrey

"At the beginning of 2022, interest rates started to go up and then there was the invasion of Ukraine. That's when you began to see IPO markets become quiet everywhere. To put that in context, last year the US IPO markets were down about 92 percent, in terms of capital raising, and they're down around 50-60 percent so far this year. So, I don't think that there's less appetite to list in London at the moment; I think there's just less appetite globally."

The impact of a global economic slowdown on IPO activity is clear to see. However, others do suggest there are more factors at play affecting the UK more broadly, such as Brexit, and therefore London's status as a place to conduct a listing. **Jon Jayal**, CEO of AIM-listed Nexteq, highlights 'big structural issues' that have come to the fore over the last decade. "[The UK has] gone through some fairly tumultuous times and that turmoil has, if nothing else, distracted governments, companies and the general population from focusing on economic growth, on progress and technical development," **Jon** says.

EY Strategy and Transactions Partner **Grant Humphrey** concedes that the UK's exit from the EU might have added to a 'perfect storm' of issues contributing to low IPO activity. "The one thing that the stock markets hate is uncertainty. There's been the knock-on effects of inflationary pressures, cost pressures, supply chain difficulties and an element of Brexit within London as well," he posits.

According to a 2021 UK Listing Review, the number of listed companies in the UK has fallen by about 50% from a peak in 2008, which speaks to a broader view that London is failing to attract and retain growth businesses at the rate it previously was.

A succession of headline grabbing instances of UK companies favouring a US listing this year have not helped such perceptions. In March, semiconductor designer and UK tech darling Arm Holdings announced it would be seeking a New York listing, despite lobbying from three UK Prime Ministers for a London IPO. In April, UK-based OKYO Pharma also scrapped a London berth in favour of the NYSE. In June, shareholders of CRH – a building materials giant and FTSE 100 stalwart – approved a plan to move the company's primary listing to New York. >

Nexteq plc

- Nexteq plc (formerly Quixant plc) was founded as a private business in 2005
- A leading technology partner to major global industrial equipment manufacturers
- The Group's specialist outsourced solutions support customers in selected end markets through its two divisions, Quixant and Densitron
- Listed on AIM in 2013, Nexteq is a profitable and cash generative business
- Headquartered in the UK with offices in seven countries, Nexteq has over 240 employees at present

Ian Simm, founder and CEO of Impax Asset Management Group, believes that the London market retains an international outlook and global investor base but is faced with a few challenges, not least a real shortage of UK-sourced capital for equities.

"If you want to raise new capital or list a company, the number of domestic sources of capital is much smaller relative to 20 years ago," he states. "That appears to me to be the biggest headwind that the London Stock Exchange is facing."

Ian also feels that there needs to be a complete rethink of defined benefit (DB) pensions schemes in the UK. "We've got too many fragmented DB schemes. And those schemes are quite likely to be considering selling out to insurance companies, in which case their interest in equity investment is going to collapse to zero."

He cites ideas put forward by groups such as the Tony Blair Institute around creating larger pooled vehicles for DB schemes to fold into, replicating pension models used in Canada, Australia and the Netherlands which have "brought down management costs and opened up opportunities around risk taking, which can then provide sources of domestically sourced capital for the stock market.

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> Ian Simm

"One thing that the UK needs to do around revitalising its capital markets is not to relax governance, but to facilitate the further pooling of pension schemes," **Ian** asserts.

Grant recognises that the underlying strength of the London financial market remains intact, but that broad-based reform has been sorely needed for many years: "I think it [London] had got itself into a position where certain rules and regulations had not quite moved on with time, which I think everyone has recognised."

The 'everyone' **Grant** refers to encompasses a broad coalition of actors serving the UK capital markets, and a reform agenda which aims to catapult the City back to a position of global leadership in finance and public markets.

Sweeping Reform Agenda

"You're seeing the biggest change agenda for the UK capital markets since the 1980s. It touches all different parts of the capital markets," **Charlie** declares.

In May, the Financial Conduct Authority (FCA) first proposed a simplification of the listing regime through London, which would see the Premium and Standard segments of the market replaced by a unified Main Market.

"That is an enormous change in the UK listing rules and it's designed to put the UK into alignment with overseas markets. It would allow companies to raise capital as flexibly as they would do in other markets, so that they can compete with private equity and compete with companies listed in overseas markets," **Charlie** says.

The FCA believes that the listing change will help 'attract a wider range of companies, encourage competition and improve choice for investors'. But for **Jon**, there is a slight worry that a convergence between the AIM and Main Market would have adverse effects on certain issuers, including Nexteq.

"The two markets are for different things and should be used by companies for different reasons. If you're on the Main Market, you're a grown-up business with a deep compliance team, a deep legal team and so on. With AIM, the idea is >

Impax Asset Management plc

- Founded in 1998 and has been a pioneer in the development of investing in the transition to a more sustainable economy
- One of the largest investment managers dedicated to investing in sustainable markets globally, with around £40 billion AUM
- Listed on AIM in 2001, but has had an investment trust (Impax Environmental Markets plc) listed on the Main Market since 2002
- Green Economy Mark accredited since 2019

you've got a NOMAD and other advisors to help with regulatory compliance, messaging and your handling of the stock market and you therefore have an internal overhead associated with being listed.

"I think the danger is if you make the AIM regulatory burden too heavy and push it towards the Main Market, that then means that you lose the creativity and innovation that AIM companies come up with."

FCA Listing Changes Proposal

- The FCA proposal aims to reform and streamline listing rules in the UK to help attract a wider range of companies and improve choice for investors
- The UK listing regime has been seen by some issuers and advisers as too complicated and onerous
- Proposed changes to the listing rulebook include replacing its existing 'Standard' and 'Premium' listing segments with a single category for equity shares in commercial companies
- A single equity category would remove eligibility requirements that can deter early-stage companies, be more permissive on dual class share structures and remove mandatory shareholder votes on transactions such as acquisitions
- The FCA's work on listings is a key part of its commitment to strengthen the position of UK wholesale markets, which is a priority in its 3-year strategy

Exactly where the regulatory line is drawn for companies under the new system remains to be seen, but **Grant** feels that the FCA proposal is a step forward, particularly around "the ability to lower free float and a slightly looser regulatory environment", although "there are pieces of it we think need to be tailored such that they don't almost go slightly too far and remove the element of investor protection which is one of London's strengths".

Ian agrees: "One of the attractions of the London market is its reputation for high-quality governance, so I think the London Stock Exchange is to be commended for not running the race to the bottom around governance."

One part of the broader capital markets reform agenda looks at research coverage. The Investment Research Review was launched in March to consider levels of financial services investment research in the UK and its contribution to UK capital markets competitiveness. Its Chair Rachel Kent, Partner at Hogan Lovells, presented her recommendations to the UK Government in July, which include introducing a Research Platform to help generate research and allowing greater access to investment research for retail investors.

Corporate governance is another piece of the puzzle, with the Financial Reporting Council recently releasing a review of its Corporate Governance Code and is also set to update its Stewardship Code. The UK Government is also actively looking at pensions capital and how to address a significant reallocation away from equities over the last 20 years, as earlier alluded to by **Ian**.

"There's around 27,000 defined contribution funds managing, on average, approximately £20 million," **Charlie** says. "So how do you create the UK's equivalent to the Ontario Teachers' Pension Plan? Having these very large pots of capital would benefit the high-growth businesses that are looking to raise capital in the UK and UK pensioners who are not currently getting exposure to many of the fastest growing UK businesses."

UK Chancellor Jeremy Hunt's Mansion House Reforms, outlined in July, aim to unlock £75 billion of additional investment from defined contribution pension funds for high-growth businesses, with the wide-ranging measures set to build on the Edinburgh Reforms of 2021.

Supporting all of the different aspects of the reform agenda is the Capital Markets Industry Task Force (CMIT), which was set up a year ago to bring people from different areas of the ecosystem together, headed up by London Stock Exchange CEO Julia Hoggett.

Those actively involved in the CMIT range from Chairs of public companies and founders of private companies all the way through to asset managers, pension providers and investment firms, with the overarching goal to identify the barriers that exist between the flow of capital in the UK.

A World-first

Another aspect of the sweeping reform programme is the London Stock Exchange's recently unveiled plans for a world-first public trading venue for private companies, which could be launched as early as next year. >

The move is perhaps in response to a growing number of public companies moving to private ownership – a trend which **Charlie** believes has been prevalent for over 20 years in the UK, Europe and the US. It is also based on appeals to harmonise thinking around regulation, disclosure and reporting for both public and private entities.

"We aim to be the first global exchange group which is genuinely indifferent as to whether a company is public or private. So being able to provide venues for companies to raise capital at different points of their lifecycles. We call that the funding continuum."

The new exchange's working title is the 'Intermittent Trading Venue' and it is designed to allow private companies to occasionally "access the public markets' pipes and plumbing, to provide secondary liquidity for shareholders on their register", **Charlie** says. "That should provide the UK with the world's first genuinely cohesive funding continuum," he adds.

Thinking back to Nexteq's IPO in 2013, **Jon** emphasises certain benefits associated with being a publicly traded company. "Coming onto the public markets was more about the degree of status and resilience it afforded us. That was important from the point of view of selling to billion-dollar customers as an outsource player to support their businesses.

"We think we're in the right place. We believe there is healthy growth potential from the business over the medium term and this makes for an attractive proposition for public market investors. And we think that the opportunity on

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> Charlie Walker

AIM in terms of attracting new investors, particularly as you start to ebb up your market cap size, is sufficient."

While there are clearly a number of deep-seated challenges residing within the UK capital markets system, there seems to be fresh optimism around future prospects for issuers and the broader arrangement of publicly traded capital, driven by a concerted and holistic effort from key players to transform what has become a fairly sluggish part of the economy.

"I think that the changes are very exciting," **Charlie** exclaims. "Their purpose is to boost the functioning of capital markets and get capital to companies that can drive both their own growth, that of the British economy and also London's position as a global financial centre, which is hugely important to the country.

All of the changes that we're seeing coming through at the moment can only be positive towards achieving that goal."

Finally, there is a feeling that the IPO market reached a floor in the first half of the year, and with inflation starting to fall on a more consistent basis, advisors are looking towards year-end with regards to bringing clients to market.

"There's a pipeline of companies that we're talking to and hear of in the wider market that are considering the UK," **Grant** reveals. "So, I think longer term, if a modified form of the FCA changes go through and all the other aspects happen, everyone keeps the momentum behind that journey." ■

Criticaleye is hosting its annual **Growth Company Forum** on 28 September. Please click here for more information or to register to attend this virtual event.

Featuring Commentary From:

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