UK FINANCE

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Building a better working world

UK CAPITAL MARKETS

Building on strong foundations

May 2023

ABOUT UK FINANCE

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms across the industry, it seeks to enhance competitiveness, support customers and facilitate innovation. Our primary role is to help our members ensure that the UK retains its position as a global leader in financial services. To do this, we facilitate industry-wide collaboration, provide data and evidence-backed representation with policy makers and regulators, and promote the actions necessary to protect the financial system. UK Finance's operational activity enhances members' own services in situations where collective industry action adds value. Our members include both large and small firms, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. Further information is available at www.ukfinance.org.uk.

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Capital markets drive modern economies. They enable and support lending and investing – from large multinational companies through to mortgages, savings products, and our pensions. They are vitally important to the UK's economic future, and we need to ensure our markets continue to work for an evolving population and economy.

Cycles of innovation and reinvention are a fact of life. Our response to these cycles – be it a result of technological change, politics, or the changing priorities of companies and investors – is what determines success. Adaptation and innovation have enabled the UK to be one of the world's pre-eminent financial centres. That position is under threat. We have more challenges to that position than at any time in the last 35 years, and so we must continue to evolve and innovate.

It is for this reason that we have partnered with EY to examine the evidence and cut through the noise. Our report not only looks at the current state of play, but also sets out findings and proposes a series of recommendations for consideration based upon data and market sentiment.

We would like to thank all the stakeholders, market participants, companies, and our members that gave us their time. Everyone we spoke to had a fascinating and captivating story to tell. We therefore had a great responsibility to do their stories justice. We would also like to thank EY for their support on this journey.

This report is our contribution to a generationally important debate. By championing what we do well, being honest about what we can do better, and being excited for the opportunities ahead, together we can build on strong foundations and ensure the UK's capital markets can deliver for everyone.

EY FOREWORD

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UK capital markets have long been considered a 'jewel in the crown' of the broader financial services sector, with a global reputation and standing, large pools of capital, and strong governance and transparency, bringing numerous benefits to the wider economy. Today their traditional strengths and status are being challenged by an ever-changing macroeconomic and geopolitical environment, combined with the evolving needs of companies and investors.

EY is proud to have supported UK Finance in providing a detailed understanding of the current state of UK capital markets, particularly focused on equity capital markets and growth. The quantitative analysis, including the size of the market, survival rates of companies, availability of capital, combined with feedback from over 100 market participants and industry experts through interviews and surveys provides a real depth of insight on the key strengths and areas for attention for UK capital markets.

Many of the concerns raised by the market participants are not new; however, their continued persistence in 2023 highlights that whilst regulatory reform initiatives and other actions have been undertaken or are in progress, there is potentially further action required to address the structural considerations which may still exist.

Despite the wide range of market participants engaged as part of this report, including pre-listed companies, public companies, investors, and advisers, it is important to note that not all market participants or stakeholders have been involved. Therefore, it is critical to ensure that the recommendations derived from this data by UK Finance are further tested to ensure alignment with the objectives of real economy businesses, the financial services industry, policymakers, and the wider public.

BACKGROUND AND OBJECTIVE

Dynamic and well-functioning capital markets play a critical role in supporting the UK real economy. By helping to finance the growth and scaling of companies, facilitating investment, providing liquidity and helping to secure long-term personal futures, for example, through pensions – the capital markets are central to securing economic futures across all the nations and regions of the UK.

The UK capital markets remain one of the strongest in the world, providing a wide range of benefits

£14.7bn

of equity raised in 2021 for UK and international companies.

8.3%

contribution from the financial services sector to UK GDP.

A talent pool of

1.2mn

employed in financial services.

£11.6tn

of assets under management (AuM) in 2021.

Figure 1: The UK capital markets remain one of the strongest in the world
2021

Source:
Ecosystem – UK Parliament and Zippia (for financial services); ONS, US Bureau of Labor Statistics, Eurostat (for Workforce jobs); Worldbank (for Political stability index)
Companies – Stock Exchanges, WFE, Refinitiv
Investor base – Investment Association, BCG

Note:
i. Talent pool by number of jobs in the financial and insurance sectors.
ii. BCG; Global Assets Management 2021; Estimated value by applying 90% to North America total AuM.
iii. Percentile Rank (0-100) indicates the rank of the country among all countries in the world.
iv. Stock exchange market capitalisation: Calculated as the aggregated value of market capitalisation of all listed companies from the issuer list of the given exchange (includes companies who are not exclusively listed on the given exchange).

A new macroeconomic environment, ongoing sectoral shifts and technological advancements have changed how companies and investors behave – with global capital markets at an inflection point.

This report touches upon many facets of the wider capital markets and private market ecosystem; however, a large proportion of what is covered is written in the context of the UK's equity markets. Whilst the UK's equity markets have long been strong, there is an opportunity for the UK to reflect, rethink and reinforce.

- **Reflect:** Consider the UK's place within evolving global equity capital markets.
- **Rethink:** Identify how UK equity capital markets can adapt to best serve the needs of current users and those of tomorrow.
- **Reinforce:** Pursue measures to strengthen the UK's position as a market of choice for companies for decades to come.

Over the past few years, there has been an industry-wide focus on enhancements to the regulation of the broader UK capital markets, including through the Wholesale Market Review, UK Listing Review, Independent Strategic Review of UK FinTech, the Secondary Capital Raising Review, the Edinburgh Reforms and, most recently, the second phase of the FCA's Primary Markets Effectiveness Review.[1,2,3,4,5,6] The efforts of the UK regulatory community have resulted in changes being made already, with further regulatory initiatives in progress. The Capital Markets Industry Taskforce (CMIT) has been established to maximise the impact of these initiatives.[7] This report is a complementary next step in this journey, set against a backdrop of competing perceptions on the strength of the UK's equity capital markets – perceptions which are increasingly being played out in the public discourse.

The following chapters explore the broad spectrum of regulatory and non-regulatory factors that influence the decisions made by companies and investors using the UK's public and private markets. This research is based on detailed quantitative analysis, supplemented with extensive qualitative insights gathered through more than 100 interviews and survey inputs from across the market ecosystem, including:

- Pre-IPO companies
- Publicly traded companies
- Advisers, including investment banks, law firms, and accountancy firms
- Investment managers
- Infrastructure providers (e.g., trading venues, technology solution providers)
- Trade bodies and industry organisations

In bringing together data and market sentiment, the objective is to present a clear and frank assessment of UK equity capital markets today and explore a vision for the future.

The data typically covers 1 January 2017 to 31 December 2021. This acknowledges that 2022 was an extraordinary year due to the macroeconomic and geopolitical conditions. 2022 data is used in appropriate circumstances. The jurisdictions covered in the report include the UK, France, Netherlands, US, Hong Kong and Singapore, given the international focus and nature of these markets.[8]

1. https://www.gov.uk/government/consultations/uk-wholesale-markets-review-a-consultation
2. https://www.gov.uk/government/publications/uk-listings-review
3. https://www.gov.uk/government/publications/the-kalifa-review-of-uk-fintech
4. https://www.gov.uk/government/publications/uk-secondary-capital-raising-review
5. https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms
6. https://www.fca.org.uk/publications/consultation-papers/cp23-10-primary-markets-effectiveness-review
7. https://capitalmarketsindustrytaskforce.com/
8. Frankfurt, Shenzhen and Shanghai Stock Exchanges, for example, are not covered due to domestic focus.

EXECUTIVE SUMMARY

The UK has been a leading global centre for capital markets for decades. This success is facilitated by the key raw ingredients of an open economy underpinned by strong institutions and a leading regulatory framework that helps reinforce the positive global reputation of the UK as an open, international market. This reputation enables the UK to access a large pool of global talent, supporting sectors and ancillary services.

The growth and evolution of the UK's market have also led to the development of a broader supporting ecosystem such as banking, payments, risk management, derivatives, capital raising, advisory services, insurance and a host of tier 1 professional services that further add to the strength and cluster effect of the UK's financial services hub. This is why many international companies have established, invested and grown in the UK.

The world and the financial services landscape are changing rapidly, driven by innovation and material, technological advancements. Many long-established companies remain and thrive and have been joined by a new cohort looking to establish themselves, grow at scale and shape the products and services of an evolving and equally innovative population – banking and finance and other traditional sectors such as mining and engineering are now joined by FinTech, CleanTech, MedTech and more.

As such, the capital markets built over the decades of the 70s, 80s, 90s and beyond need to adapt and evolve to achieve two critical goals. One – continue adequately serving the long-standing established companies that make up the critical mass of the economy and stock exchanges, and two – harness, nurture and grow the emerging new cohort of companies beginning their journeys.

As this report sets out, the route to achieving these goals is not only through amendments to laws and regulations. It requires a national conversation about attitudes to saving and investing, how to invest in the future, manage pensions and whether we invest enough in financial education in the early years to drive a culture of financial empowerment in later years. We need to create a market system that works not only for sophisticated investors and corporates, but for everyone. It will also require a reassessment of the fundamentals on which our capital markets ecosystem is built, both to understand the role these have played in getting to where we are today and, more importantly, how they can be optimised to ensure they continue to be fit for purpose for tomorrow.

Addressing these challenges is a worthy pursuit. Just as forests and trees support a much wider ecosystem of other life, thriving capital markets can support companies to grow and investors to optimise their returns leading to effective and sustainable economies. In this context, this report refers to and touches upon many facets of the UK's capital markets ecosystem but largely speaks to the equity markets, given that they are often seen as a proxy for the success of the broader capital market.

Therefore, a strong and dynamic market becomes a strategic and economic priority for the UK. As noted above, this means creating the right conditions to encourage new companies to raise capital and grow in the UK and nurturing the evolving and more mature companies that provide the critical mass to our economy. Those conditions should result in an environment that generates and enables a sustained flow of UK growth capital throughout the early stages of a company's lifecycle, accompanied by assistance and guidance to navigate the transition from seed funding through private capital-funded growth to SME-focussed and then more senior markets. Along the way, it will be important to remove frictions and barriers to growth, so we not only generate successful companies but enable them to stay in the UK.

The prevailing public discourse has started to paint a picture of the UK losing some of its attractiveness, with reports of poor-performing IPOs and companies choosing to list elsewhere. This narrative focuses on the UK lagging behind the US in technology and high-growth company valuations.

This report explores and unpicks these perceptions through quantitative market data and feedback from market participants. It then identifies areas for improvement to enhance the competitiveness of the UK's capital markets. The findings should be considered complementary to, and read alongside, the existing reviews and reports that look at boosting UK competitiveness in capital markets.

By way of illustrative example, included below are some key findings, our recommendations and an outline of what a successful capital market may look like by 2030.

While the data continues to show the UK's strong position, it also indicates some trends in continued de-equitisation of the UK markets, preference of private capital over public capital and the attraction of UK companies to other international markets.

Understanding the key challenges

To examine the current state of the equity market, data was assessed over a historical period and relative to other exchanges. Interviews and surveys with market participants across companies, advisers, investment managers and infrastructure providers were undertaken.

The analysis of the data and feedback identified four key challenges that interviewees felt needed to be addressed to maintain and enhance the global competitiveness of UK capital markets.

1. **SMEs need more help to access UK capital markets:** Companies, especially in non-traditional or tech sectors, find attracting the appropriate growth capital at various growth milestones challenging. The listing process and the journey to becoming a publicly traded company were also seen as overly complex and costly.
2. **UK capital does not always reach UK companies:** It was felt by a number of the market participants interviewed that UK investors (depending on their characteristics) prioritise: (a) capital returns over the patience needed for longer-term returns in growth companies and (b) saving in cash or other liquid products rather than investing for the future. Some respondents consider that this was due to historical changes to insurance rules and pension reforms. UK retail investment in equities was also seen as an area that could be improved when comparing rates of retail participation against the US and the EU.
3. **Too much friction is stifling capital flows:** There is a demand to simplify and streamline operational processes, such as introducing technology to improve efficiency, addressing the burden of duplicative continuous obligations, and considering the benefits of tokenisation. A better transition from AIM to the Main Market was also identified as an area for improvement.

4. **The UK's profile overseas is suffering:** Respondents and interviewees considered the UK has an opportunity to redefine how it showcases itself to global market participants. The public discourse was perceived to have had a disproportionate focus on corporate failure rather than championing success, which was in sharp contrast to the perception of the US as a pro-business environment. An often-cited example was the difficulty to attract and retain global talent.

To supplement these insights, companies were asked to rank the key features they look for when choosing which exchange to trade on.

Top five influencing criteria when considering an exchange

1. **Access to a strong investor base:** Access to sophisticated investors with a sector and business model understanding.
2. **Valuation and research coverage:** Research analysts with appropriate depth of knowledge to be able to provide insights for investors.
3. **Liquidity:** Sufficient market volume in the aftermarket, index eligibility and volume of trading in indices.
4. **Comparable companies:** Presence of comparable companies on the relevant market.
5. **Ease and cost of being publicly traded:** Cost and complexity of the process, driven by regulatory, accounting and disclosure requirements, and the availability of support during the process.

Addressing the key challenges

To address the issues identified, we have proposed a series of actions under four separate themes:

1. Address the structural challenges hindering UK growth companies
2. Reboot the nation's culture towards financial empowerment and entrepreneurship
3. Continue to improve 'the plumbing'
4. Reinforce the UK as a destination of choice

Coalescing around change

There was an overriding sense amongst market participants that there can be no room for complacency. Many of the areas for attention and remedies identified have been part of the discourse for some time. That in itself is significant, but now it is essential to build on the progress in areas like regulatory reform and address remaining barriers to growth and the development of the UK markets.

The challenges identified in this report require the ecosystem to come together. It is no small task, but the potential reward is material.

CHAPTER 1

The UK capital markets today

1.1. OVERVIEW

UK capital markets are underpinned by strong fundamentals

The infrastructure at the heart of a thriving capital market consists of companies, investors, and an enabling ecosystem, all linked together to establish a 'virtuous circle'.

The UK is a leading global centre for capital markets with a deep and broad offering, supported by a strong talent pool and a network of linked stakeholders, including world-class legal and professional services expertise. This is underpinned by a strong and evolving regulatory framework central to the UK's positive global reputation as a place to do business.

1.2. A STRONG MARKET

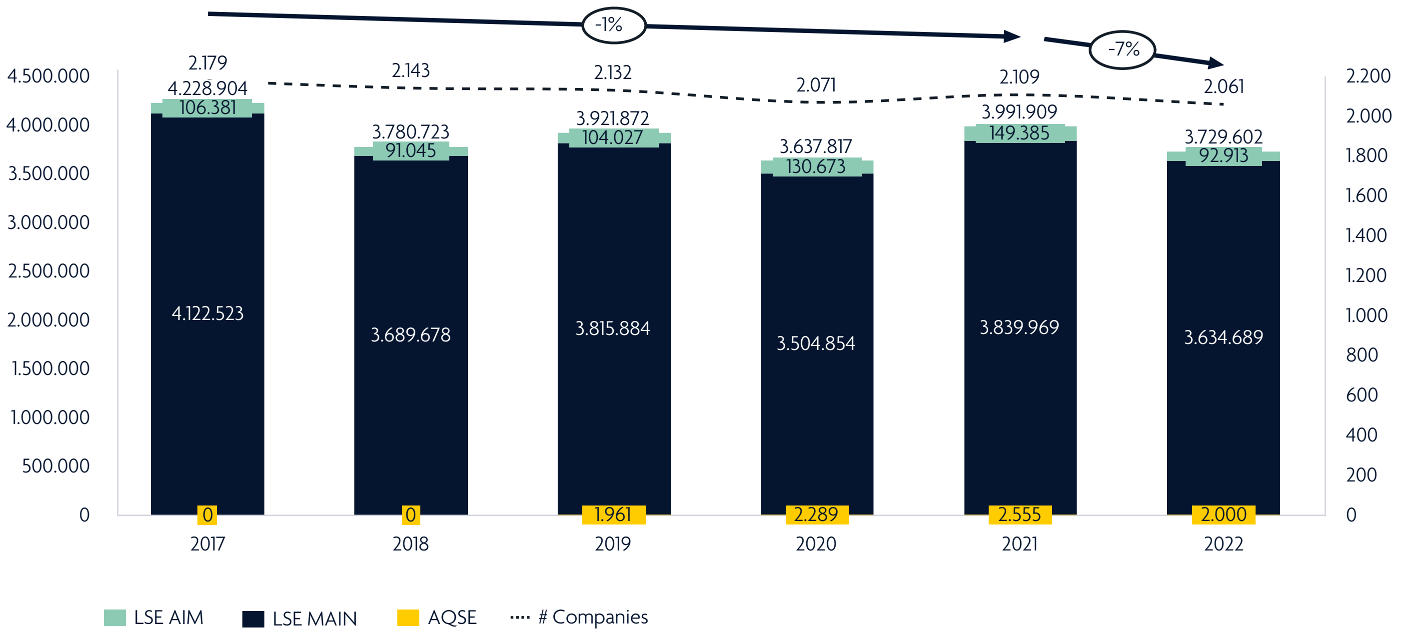
The UK market has several advantages, including:

- The breadth and depth of the wider public market, including the equity and debt markets.
- A well-respected legal and regulatory environment.
- A strong blend of competencies, skills and talents. The UK has a pool of 1.2 million finance and insurance employees who support companies through their lifecycle, and access to private and public financing for growth.
- A strong secondary market infrastructure with diverse trading mechanisms that help to meet the investment needs of different investors.
- Robust and timely information flows to support investment and insights for investors.
- A significant cohort of investment research analysts.
- A listing process with costs comparable to other major markets.
- An established global reputation in services with a long history of contractual certainty and trust in the UK's public institutions.

Focusing on the equity capital markets, a key component of this report, the UK has an equity market capitalisation of £4tn and hosts one of the world's oldest stock exchanges. Over 2,000 companies have been admitted to trading on the UK's primary markets with a new equity issuance of £14.7bn from 126 IPOs in 2021.[9,10]

Figure 2: UK equity market capitalisation by stock exchange

£mn, 2017–22

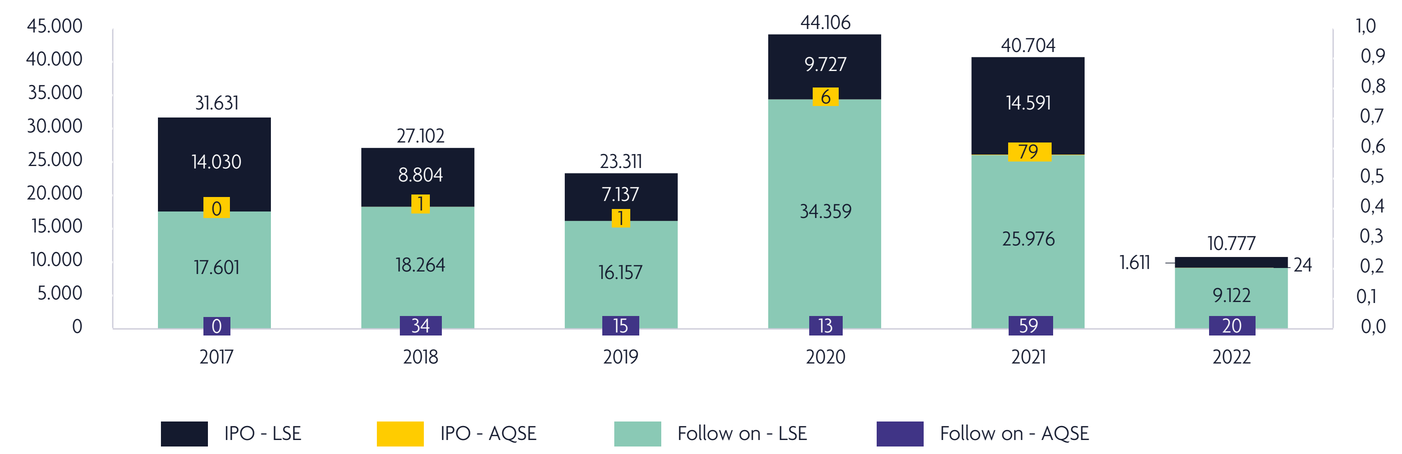


Source: LSE, Aquis

The global pandemic and recent geopolitical uncertainty highlighted the strength and resilience of UK equity markets, with companies continuing to be able to raise capital. Between March 2020 and November 2021, UK businesses raised around £77bn of net additional financing through UK-based banks and financial markets. This allowed many to leverage the UK's global markets to weather the impact of challenging economic conditions.

Figure 3: UK total capital raised

£mn, 2017–22



Source: LSEG

9. Including the London Stock Exchange (2,017 listed companies, £4.0tn market capitalisation, and £14.6bn IPO capital raised by 126 companies) and Aquis Exchange (92 listed companies, £0.003tn market capitalisation, and £0.079bn IPO capital raised by 14 companies).
10. Unless otherwise specified, LSE refers to the Main and AIM markets, and UK refers to LSE and Aquis stock exchanges.

1.3. THE VIRTUOUS CIRCLE

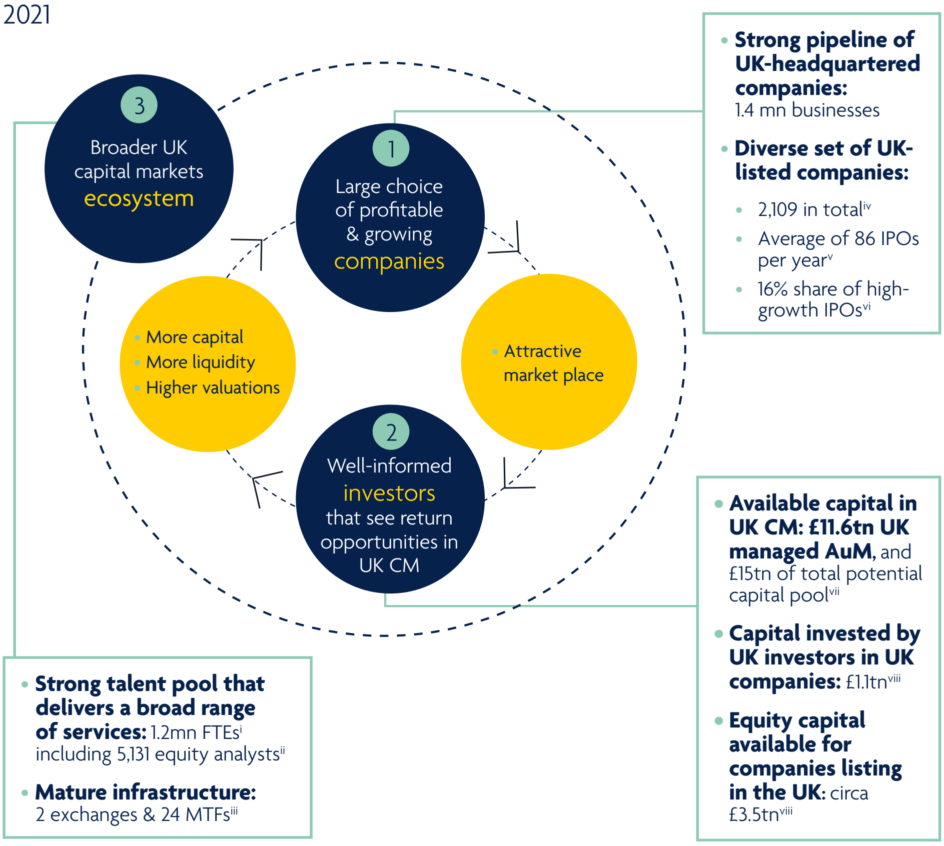
The infrastructure for fully functioning and competitive capital markets consists of three main components.

1. **Companies:** A critical mass of diverse companies across all sectors and stages of growth. The development of innovative companies with the ability to grow and scale is a key driver of future success.
2. **Investors:** A varied and actively engaged investor base with an appropriate risk appetite who can provide the capital and liquidity for funding requirements as companies grow and scale. This includes institutional, private and retail capital.
3. **Ecosystem:** An ecosystem that facilitates and enables a broad and deep market. This includes proportionate and agile regulation set in conjunction with global standards, a proportionate tax regime including targeted tax measures to support specific sectors and an investment culture that supports growth-orientated businesses.

These three components establish a 'virtuous circle' to create a unique and resilient interrelated infrastructure serving companies and investors.

Figure 4: The UK capital markets today

2021



The 'virtuous circle' drives the successful outcomes that are the fundamental requirements of a thriving capital market:

- It attracts a broad range of companies, including those from high-growth sectors.
- It is comprised of well-run domestic and international companies.
- It attracts strong capital flows, ensuring companies have sufficient capital and liquidity to achieve their objectives.
- It enhances shareholder value and long-term stewardship.
- It facilitates access to global and domestic companies and investors worldwide.

Notes:

i. FTEs in finance and insurance activities in the UK in 2021; Source: ONS.
ii. Equity analysts' data for the UK, as of Dec 2022; Source: Refinitiv.
iii. 2 exchanges offering primary equity issuance and 24 MTFs approved by the FCA; Source: FCA.
iv. Based on the number of companies on the LSE and Aquis stock exchange in 2021. International is defined as companies that are not UK-incorporated.
v. Average number of IPOs between 2017 and 2022 on LSE and Aquis stock exchange.
vi. Based on 2021 Market Cap of high growth sectors, which include Technology and Biotechnology, compared with total free float of LSE-listed companies.
vii. £15tn includes deposits and cash ISA; Source: Investment Association; Source: GOV.UK.
viii. Proxied by percentage of institutional AuM invested in global equity and UK equity.

CHAPTER 2

The strength of the UK virtuous circle

2.1. OVERVIEW

The UK equity capital markets are at an inflection point

The broader UK market remains strong and continues to benefit from the cluster impact of being a global financial centre – attracting a large talent pool, a diverse range of capital providers, specialist sectors and engaged trade bodies.[11] The UK is a global hub for this cluster of financial and professional services. This continues to be a significant benefit for companies considering where to scale and grow their business.

The UK also has a strong and proud tradition of innovation and facilitating start-up companies, with further growth expected to continue.

Despite this, some smaller companies struggle to attract the capital they need to help them scale. Where they are supported, this tends to be by international private capital. This capital can then influence those companies to choose exchanges outside the UK for the next phase of their growth. This may be due to a perception that joining other exchanges will result in a better valuation.

2.2. COMPANIES

The importance of achieving scale

Of the 5.5mn companies in the UK, 1.4mn are larger than sole traders and are potentially within scope to access UK capital markets; acknowledging that not all companies will scale to sufficient size or choose to access public markets, the demand to access and utilise UK capital markets should still grow over time as the number of newly registered companies in the UK increased by 7% annually from 2017 to 2020.[12] However, growth in the number of domestic public companies (-1%) fell short of the rate at which new businesses are registered.[13]

Figure 5: Number of UK companies by size

Absolute value, 2021

Size		Average revenue (£k)	Total number of companies
Size	All	£2,765[i]	1,447,900
Size	1-9 employees	£447	1,187,045
Size	10-50 employees	£2,803	217,240
Size	51-250 employees	£19,687	25,940
Size	250+ employees	£264,799	7,675

Source: GOV.UK

i. Weighted average

11. A feature of the UK, compared with the US for example, is the quantum of UK traded company shares held by global institutional investors.
12. World Bank and Federal Reserve Economic.
13. London Stock Exchange and London Stock Exchange Group; UK-incorporated companies traded on UK exchanges decreased from 1,751 to 1,682 from 2017 to 2021; -1% CAGR.

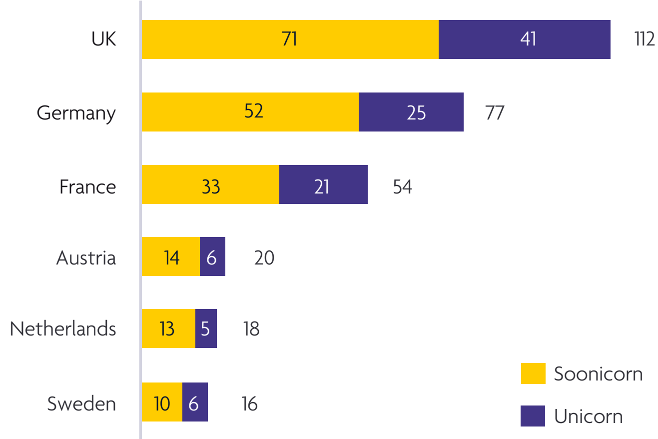
a. There is an increasing need to better support the growing number of UK start-ups

The UK has the largest number of newly registered companies in Europe, 774,000, broadly comparable with the US in terms of businesses per capita and significantly ahead of the per capita figure for other major European countries.[14,15] The UK leads the way in Europe on high-growth start-ups, Unicorns (companies valued at £1bn) and 'Soonicorns', those that are likely to become Unicorns in the next 24 months.[16] The US is ahead with 704 Unicorns.[17]

Figure 6: Number of businesses per capita
Absolute value, 2022

Source: ONS, Government website

Figure 7: Number of Unicorns and Soonicorns by selected European countries
Absolute value, as of January 2022



Source: i5invest and i5growth

The UK's start-up environment is well-capitalised and supported by government-incentivised venture capital investment schemes. There are three notable schemes: the Enterprise Investment Scheme (EIS), aimed at early-stage companies, has raised £24bn overall, with 4,215 companies funded between 2019 and 2020 alone; the Seed Enterprise Investment Scheme (SEIS) and the Social Investment Tax Relief (SEIT) scheme.[18,19] Investors can also derive tax benefits from investing in shares in a venture capital trust (VCT). A VCT is a company (like an investment trust) that has been approved by HMRC and invests in or lends money to unlisted companies. £4.4bn has been invested in VCTs since 2016.[20] These schemes, albeit beneficial for early-stage growth, are not intended to support later-stage growth as the tax benefits, and therefore capital, fall away. Innovate Finance has estimated a £15bn gap in growth capital requirements for UK companies.[21] It's at this stage where UK scale-up companies tend to turn to international private capital to fill the investment gap due to a lack of UK domestic capital.

14. The Office for National Statistics
15. World Bank
16. i5invest and i5growth; the 2022 European unicorn & soonicorn
17. Statista
18. Dealroom.co; venture capital in the UK
19. SITR will not be available for new investments made on or after 6 April 2023.
20. GOV.UK; venture capital trusts statistics: 2022
21. Innovative finance; the Future of Growth Capital

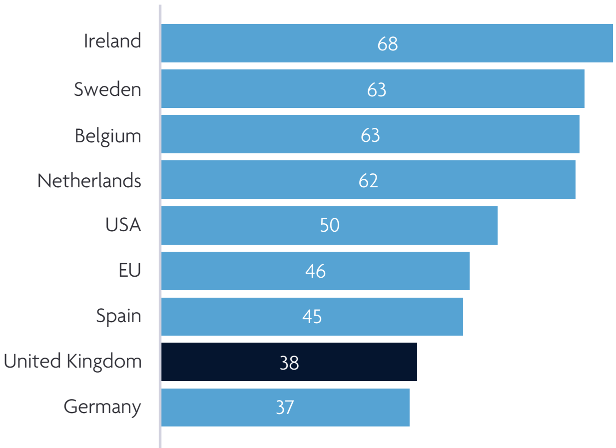
UK companies are typically less well-capitalised than their US counterparts over their full growth lifecycle, and on average, US companies raise more capital at every funding stage. The UK also shows lower five-year survival rates for newly founded companies than key major European countries and the US.

Figure 8: Comparison of funding for UK vs. US start-ups
$mn, 2017–22

	Pre–early VC (Accelerator/Angel/Seed)		US:UK funding ratio	Early VC (Rounds A–C)		US:UK funding ratio	Late VC (Rounds D+)		US:UK funding ratio
	US ($mn)	UK ($mn)		US ($mn)	UK ($mn)		US ($mn)	UK ($mn)	
1-9 employees	1.6	1.1	x1.5	2.7	1.0	x2.7	3.3	1.7	x1.9
10–50 employees	3.5	2.6	x1.3	10.4	6.0	x1.7	9.0	5.8	x1.6
51–250 employees	5.0	4.5	x1.1	57.4	19.1	x3.0	32.2	20.7	x1.6
200+ employees	–	–	–	73.2	34.8	x2.1	107.5	119.5	x0.9
Total	**10.1**	**8.2**	**x1.2**	**143.7**	**60.9**	**x2.4**	**152**	**147.7**	**x1.0**

Source: Pitchbook

Figure 9: Global five-year company survival rate
Percentage, 2015–20



Source: World Bank, EuroStat

Public companies:

While the UK nominal GDP growth was 2.2% from 2017 to 2021, UK market capitalisation from domestic companies grew at 0.8% – resulting in the market–GDP ratio decreasing from 1.3 to 1.2. The same ratio in the US over the same period went from 1.6 to 2.2. This was partially driven by increasing valuations, but it was also supported by an increasing number of companies that became publicly traded between 2017 and 2021.[22]

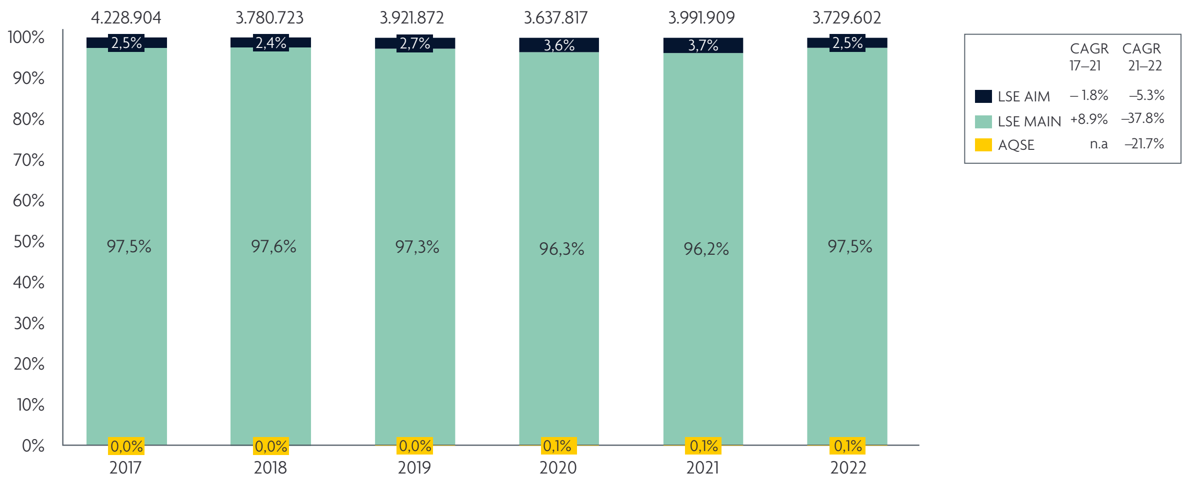
22. Nasdaq and NYSE; US incorporated companies traded on US exchanges increased from 3,359 to 4,410 from 2017 to 2021; 7% CAGR.

b. SME growth markets are growing at a high rate

For companies that have bridged the funding gap and choose to stay in the UK, there are supportive SME growth markets demonstrated by the growth in AIM and AQSE.

While the LSE Main Market represents 97% of the UK equity capital market between 2017 and 2021, AIM and Aquis exchange (AQSE) grew faster.

Figure 10: UK equity market capitalisation by stock exchange
£mn, 2017–22



Source: LSE, Aquis

c. Certain sectors are showing differentiated growth

The technology, financials, consumer and biotech sectors are expected to grow above the 2021-25 compound average growth rate (CAGR) of 6% of the UK GDP. Traditional, telecommunication, medical and pharmaceuticals sectors are forecasted to grow somewhat slower, by 4% to 5%.[23]

Consistent growth across the UK technology industry saw it reach the $1tn in value milestone in 2022, making it only the third country ever to hit this valuation after the US and China.[24] The UK technology industry is ahead of comparable technology industries in Europe and is worth more than double Germany's $467.2bn and three times more than France's $307.5bn.[25]

In 2021, the UK had 41 unicorns with capital raised of circa €23bn (as of 20 January 2022) and created over 40,000 jobs.[26] Fintech, the highest-valued sector, attracted a record investment of more than $11.6bn.[27] The Clean and ClimateTech sector secured investment of £134bn in 2021, 4.4% higher than the previous record in 2018. Research highlights there are 8,500 of these firms based in Europe, with just under 2,000 of these based in the UK.[28]

23. Traditional includes industrial, industrial support services, basic materials, energy and utilities sectors.
24. Compiled by Dealroom for the Digital Economy Council – https://www.gov.uk/government/news/uk-tech-sector-retains-1-spot-in-europe-and-3-in-world-as-sector-resilience-brings-continued-growth.
25. ibid
26. i5invest and i5growth; 2022 European unicorn & soonicorn
27. Innovative Finance; Fintech investment
28. https://www.govgrant.co.uk/sector-research/is-there-enough-cleantech-investment-in-climate-change-solutions/

2.3. INVESTORS

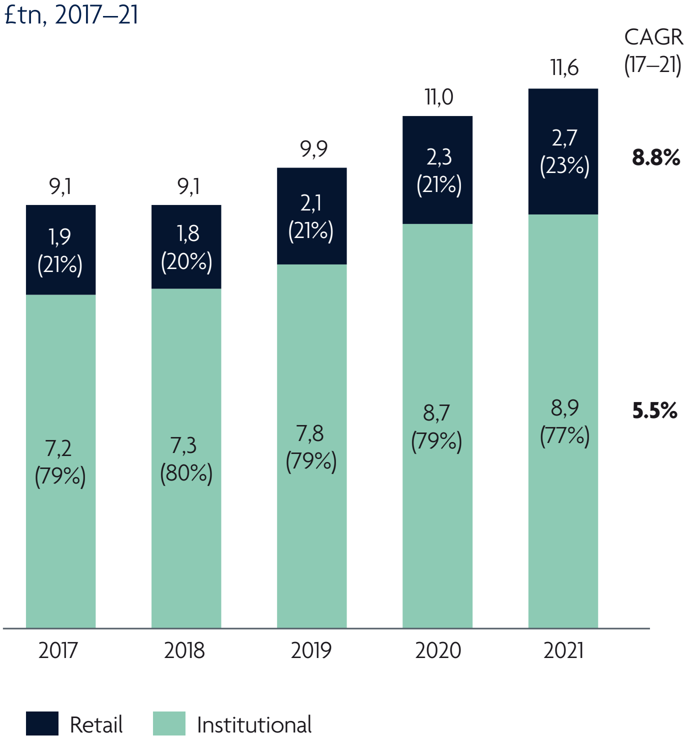
Increasing the diversification of capital investment

a. Institutional investors provide the largest contribution to UK capital investment

The UK markets manage £11.6tn of capital, with £2.7tn in retail AuM and £8.9tn in institutional AuM.[29] This pool of capital finances investments both in the UK and overseas. There is an additional £3.4tn of UK deposits and approximately £0.4bn in cash ISAs, meaning an overall pool of capital of some £15tn.[30,31]

Figure 11: UK total AuM by investor type

£tn, 2017–21



Source: Investment association, PPF Purple book

- Institutional investors provide 60% of the UK capital pool, with the biggest contributors being pension funds and insurance firms.
- Almost half of pension fund capital is in defined benefit (DB) schemes (approximately £2.3tn). DB schemes generally have an investment mandate favouring lower-risk investments (such as bonds and gilts), given the need to pay defined liabilities.[32]
- The UK had £1.7tn in funds under management that sustained year-on-year growth of 7% between 2017 and 2021.[33,34]

29. Investment Association
30. https://www.ceicdata.com/en/indicator/united-kingdom/total-deposits
31. https://www.gov.uk/government/statistics/annual-savings-statistics/commentary-for-annual-savings-statistics-june-2021.
32. EY analysis of Investment Association data.
33. Investment Association
34. 2022 funds under management saw a 13.5% outflow reflecting market volatility.

b. Retail assets play a material role

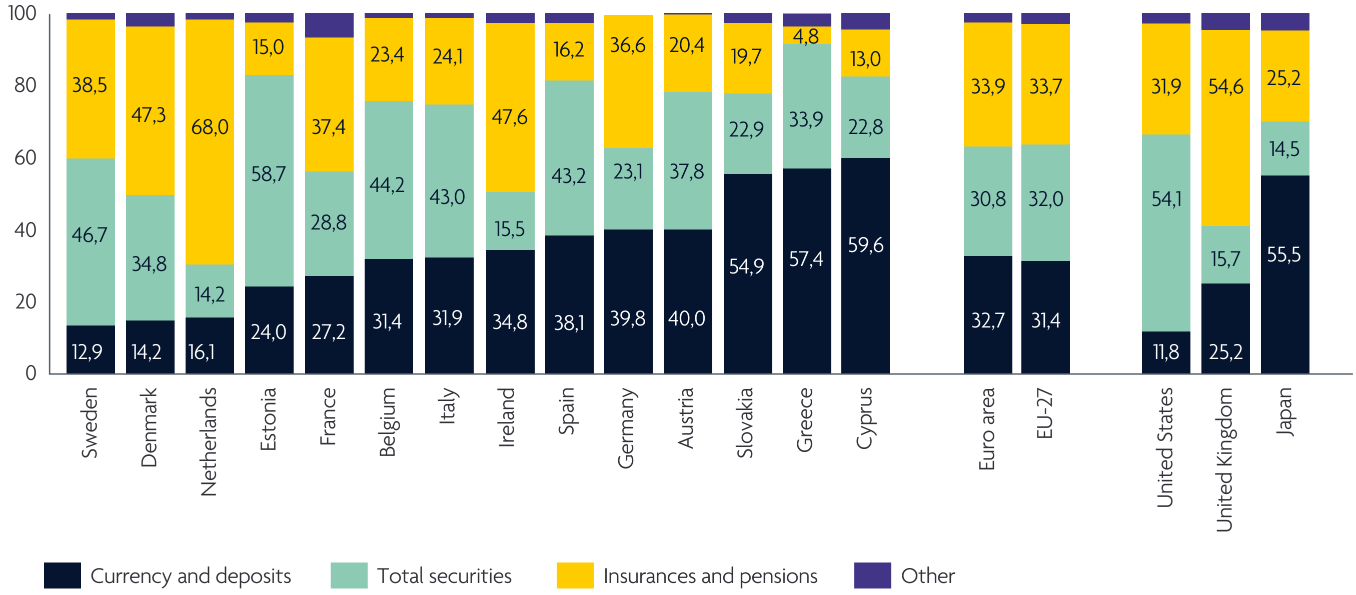
Retail AuM grew by 9% between 2017 and 2021 to a total of £2.7tn, as noted above. A further circa £3.8tn of retail cash is not invested and held in cash deposits and cash ISAs.

There are 30mn savings accounts and 27mn cumulative ISA accounts in the UK – the latter includes cash ISAs, stocks and shares ISAs, innovative finance ISAs, Lifetime ISAs, and Help to Buy ISAs.[35,] In 2020-21, roughly 8.2mn were subscribed (e.g., engaged with or newly opened) cash ISAs and approximately 3.5mn were subscribed stocks and shares ISA (noting any one person can have multiple ISA products).[36] In contrast, retail participation in capital markets-related activity is higher in the US and other European countries, e.g., in the US, there are over 100mn trading accounts with the top six online brokerages alone and over 10mn new users in 2020-21.[37]

Whilst it is challenging to identify the precise numbers of retail customers participating in the IPO market, it is estimated to be below the number of stocks and shares ISAs referenced above. Approximately half of active IPO investors are also active in follow-on capital raisings by companies already trading on the public market.[38]

Figure 12: Composition of households' financial savings in selected EU and non-EU countries

Percentage, 2019



Source: Eurofi

Note: 'Total securities' include all existing market-based instruments held directly or indirectly, in the form of bonds, equity, mutual funds and money market funds; 'Other' includes loans and other accounts receivable/payable as defined by Eurostat.

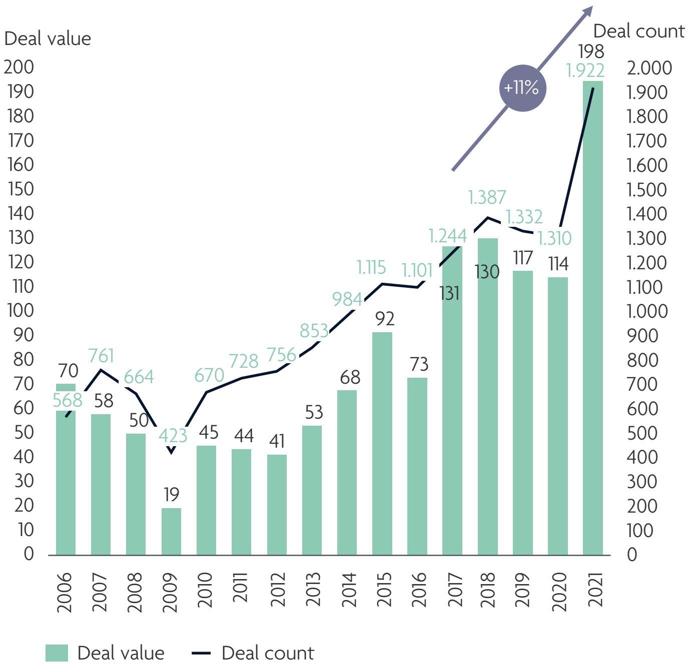
35. https://www.gov.uk/government/statistics/annual-savings-statistics-2022/commentary-for-annual-savings-statistics-june-2022
36. Gov.uk, as above. Note that HMRC data suggests that on average less than 50% of the stocks and shares ISA limit is used. Number of individual investors, however, can be significantly (up to 50%) higher than 2021 S&S ISA subscribers, e.g., users of trading and stockbroking platforms are not reflected in this number, as well as those S&S ISA customers who have investments but did not subscribe in 2021.
37. Reuters – Factbox: The US retail trading frenzy in numbers
38. PrimaryBid Investor Survey, March 2023

c. Private capital has seen year-on-year growth

Private capital, funded primarily through institutional investors, reached £0.5tn in 2021 and has shown strong growth, with an estimated CAGR between 2017 and 2021 of circa +14%.[39]

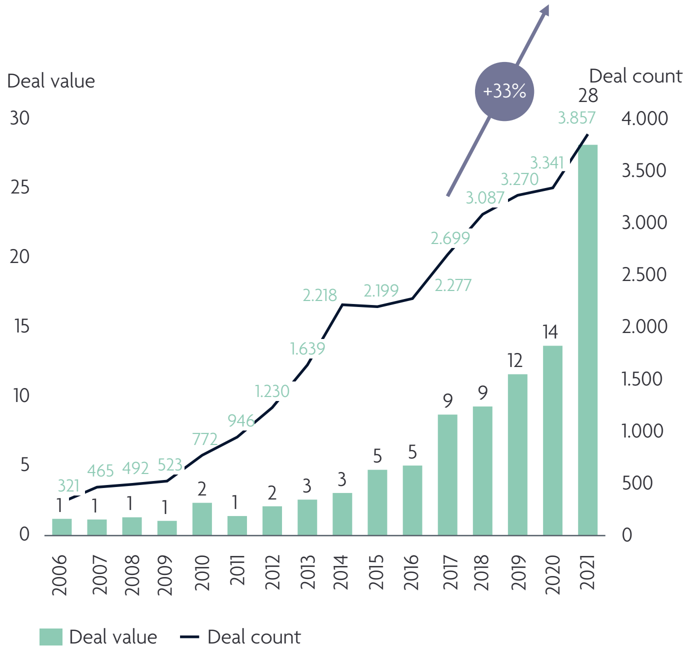
This includes a strong increase in private equity (PE) and venture capital (VC) fundraising in recent years. Between 2017 and 2021, PE deal value increased at a CAGR of 11% and 33% for VC. UK companies successfully attract international PE and VC investors, with US and European investors funding over half of UK total private capital in 2021.

Figure 13: UK/Ireland PE deal activity
£bn, 2006–21



Source: Pitchbook

Figure 14: UK/Ireland VC deal activity
£bn, 2006–21



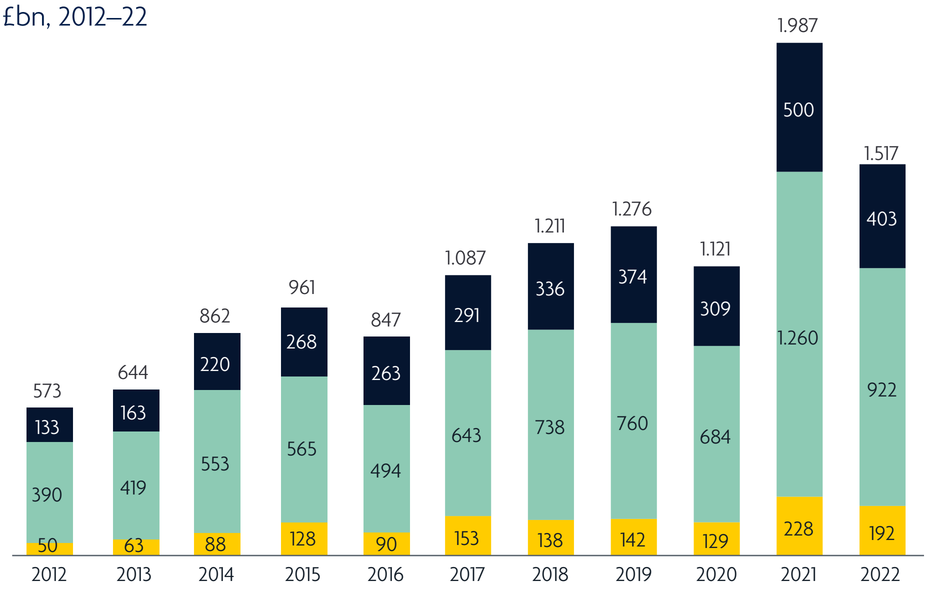
Source: Pitchbook

39. EY analysis of McKinsey data.

Whilst all other major markets show growth, the UK outperforms them all in the growth of PE deal size. Between 2012 and 2021, the UK saw PE deal volumes grow 14.4%, compared with 9% in North America and 11.7% in the EU.

Figure 15: Private equity deal value per region

£bn, 2012–22



Region	CAGR: 2012–22
EU	11.71%
North America	8.98%
UK	14.40%
Total	**10.22%**

Source: Pitchbook

* This includes EU, North America and UK only, as per Pitchbook data

d. UK capital markets continue to attract overseas investors

The UK attracts a wide international investor base, with approximately £2tn to £2.5tn invested in UK equities by overseas investors.[40] Nearly two-thirds (62%) of the shares traded on the LSE are held by non-domestic institutional investors, compared with only 18% in the US.[41]

Figure 16: LSE – Geographic breakdown of institutional investors

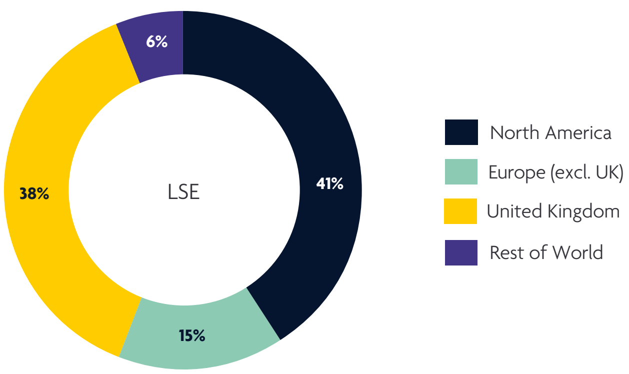
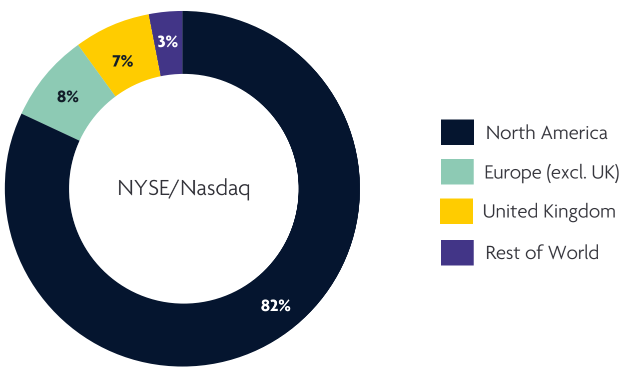


Figure 17: NYSE/NASDAQ – Geographic breakdown of institutional investors



Sources: LSEG, institutional investors analysis, Dec 2022

40. EY estimate for the amount of international capital invested in the UK, on the basis that 62% of LSE institutional investors are overseas investors.
41. LSEG analysis – December 2022.

2.4. ECOSYSTEM

A unique hub of talent, services and frameworks

- The UK has a globally leading regulatory framework supported by a strong legal system and contractual certainty.
- The UK has a cluster of talent across financial services and supporting industries, such as professional advisers, private equity and venture capital. A significant cohort of research analysts also supports information flows to investors.
- The UK has a mature primary and secondary market infrastructure. The LSE and Aquis operate primary markets aimed at a wide range of companies ranging from SMEs to mature issuers. This is complemented by a diverse secondary market structure, including several trading venues that facilitate equity trading operated by firms such as the LSE, Cboe Europe and Turquoise, and execution venues known as systematic internalisers operated by investment firms. Overall, there are a number of trading venues and systematic internalisers in the UK across different asset classes.[42] The secondary markets survey showed that:
  - There was consensus around the fact that the UK's OTC infrastructure, capital markets intermediary technology and capital markets support (e.g. consultants) are leading or comparable to other jurisdictions.
  - There was broad consensus that the UK's trading venue infrastructure is leading or comparable to other jurisdictions.

2.5. SUMMARY

UK capital markets continue to be underpinned by strong fundamentals, but it should not be assumed they will remain in place without action. Most UK-based companies have access to sufficient capital to support growth; much of that capital is from international pools. The composition of companies evolves, as well as the sources of capital. In an ever-evolving macro-environment, there are several challenges for the future of the UK's capital markets ecosystem and the companies it serves. Further feedback on these challenges and suggested recommendations are set out in the following chapters.

42. HMT, Wholesale Markets Review Consultation, July 2021 - As of July 2021, in the UK there were six firms that operate a Regulated Market (RM), 38 firms that operate a Multilateral Trading Facility (MTF) and 24 firms that operate an Organised Trading Facility (OTF). Some firms operate multiple venues. In addition, there were 65 firms that had notified the FCA that they are acting as a systematic internaliser (SI) in at least one asset class.

CHAPTER 3

Setting the record straight

3.1. OVERVIEW

The UK remains a major international IPO market

In a complex and dynamic global environment, the requirements and expectations of investors and companies have continued to evolve. In this context, some recent perceptions have developed regarding the strengths of the UK's equity capital markets and areas that require attention.

The data shows that many of the negative perceptions regarding the UK's equity markets are more nuanced than they may appear.

The analysis shows that UK equity capital markets:

- Are in the top three international markets globally.
- Attract companies from high-growth and new economy sectors.[43]
- Perform better than the US equity markets in post-IPO price performance (2017 to 2021).[44]
- Attract capital from global institutional investors.

However, there are findings which also show the challenges faced by the UK equity capital markets to maintain their position and grow:

- The UK has lost some market share to the US, as certain sectors, e.g., healthcare, have seen a significant proportion of UK companies choosing to join US public markets. Additionally, following the UK's withdrawal from the EU, more European companies appear to be choosing exchanges within the EU single market.
- In recent years, the overall share price performance on the LSE Main Market has been lower compared with the performance of comparable exchanges in other markets.
- The US has more liquidity overall, specifically in new economy sectors.

43. Example: IPO capital raised for the technology sector increased from 2% to 33% of all capital raised from 2017 to 2021, and the respective percentage for the healthcare sector moved from 1% to 3%.
44. Price performance is calculated using the trading price at 31/12/2021 and IPO offering price.

3.2. PERCEPTION 1

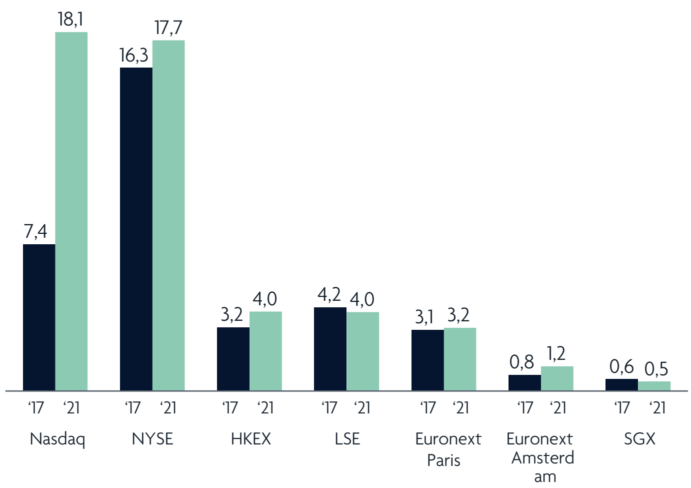
US and European exchanges are growing at the UK's expense

The LSE (Main Market and AIM) remains the largest stock market in Europe, with a market capitalisation of £4tn as of 2021. However, its market capitalisation declined by 6% between 2017 and 2021, with the contribution from new international company IPOs on the LSE down from 35% to 29%.[45] The number of companies traded on the LSE also decreased by 7.4% during this period.[46]

The principal US exchanges, NYSE and Nasdaq, have both seen growth in market capitalisation. This has been more prevalent on Nasdaq, which has seen rapid growth in technology stock valuations.

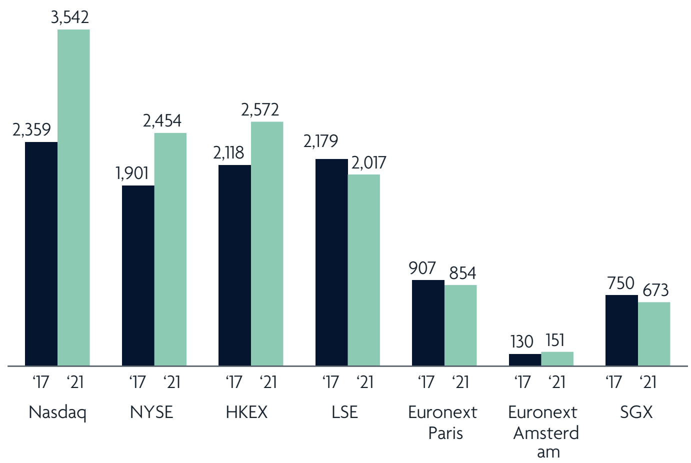
Amsterdam and Paris have both seen an increase in total market capitalisation. For Amsterdam, this increase has been driven by several new companies admitted to trading. Paris, like the UK, has seen a decline in the number of companies traded on its exchange, suggesting that there has been an overall increase in the average valuation of companies on that exchange.

Figure 18: Market capitalisation by stock exchange
£tn, 2017 and 2021



Sources: Stock exchanges, World Federation of Exchanges

Figure 19: Number of companies by stock exchange
Absolute value, 2017 and 2021



Sources: Stock exchanges

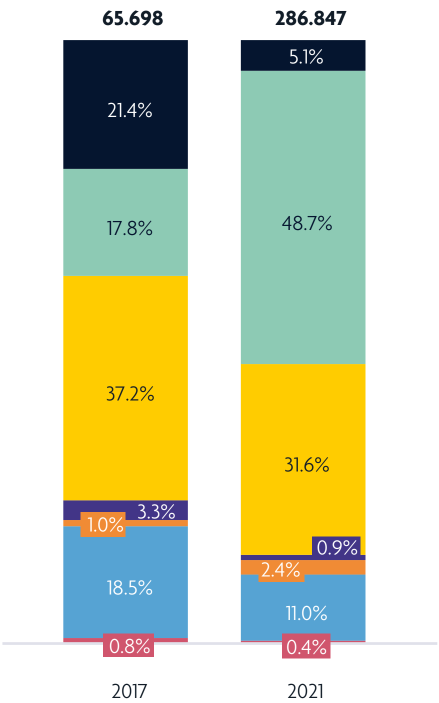
The amount of capital raised and the number of IPOs on the LSE have increased in absolute terms. However, the LSE's share relative to the international IPO market has decreased.

- The amount of capital raised through IPOs on key international markets (the LSE, Nasdaq, NYSE, Euronext Paris, Euronext Amsterdam, HKEX and SGX) increased from £65.7bn in 2017 to £268.8bn by 2021, a rise of 337%.[47]
- The LSE's share of capital raised has fallen by a factor of four; 5.1% (£14.0bn) in 2021 compared with 21.4% (£14.6bn) in 2017.
- Over the same period, the LSE saw its share of IPOs by number decline from 19.5% in 2017 to 9.1% in 2021.
- By number (including SPAC IPOs), the Nasdaq accounted for over half of all successful IPOs in 2021 (54.5%).

45. London Stock Exchange
46. ibid
47. Stock exchanges; aggregated data

Figure 20: Share of total IPOs by capital raised in value

£bn, 2017 and 2021

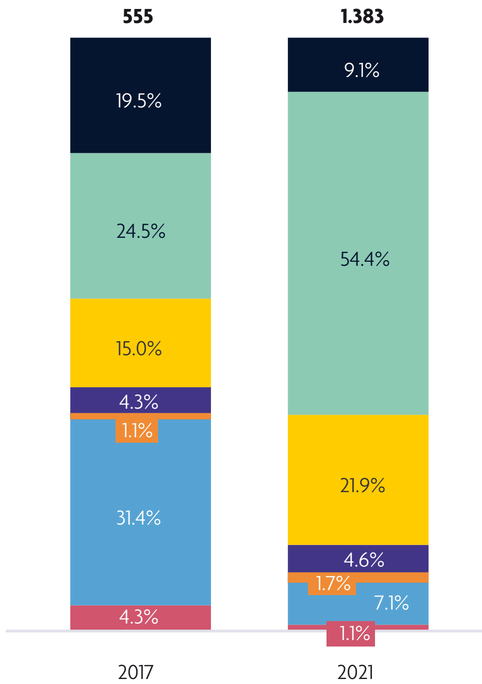


			CAGR
LSE	£14.0bn	£14.6bn	1.0%
Nasdaq	£11.7bn	£139.6bn	86%
NYSE	£24.5bn	£90.7bn	38.8%
Euronext Paris	£2.2bn	£2.6bn	4.3%
Euronext Amsterdam	£0.7bn	£6.9bn	79.1%
HKEX	£12.2bn	£31.4bn	26.8%
SGX	£0.5bn	£1.0bn	17.8%

Sources: Stock exchanges
Note: Final percentages are rounded up

Figure 21: Share of total IPOs by capital raised in number of deals

Absolute number, 2017 and 2021



LSE	108	126
Nasdaq	136	753
NYSE	83	303
Euronext Paris	24	64
Euronext Amsterdam	6	24
HKEX	174	98
SGX	24	15

Source: Stock exchanges
Note: Final percentages are rounded up

The distribution of companies on the LSE is changing to reflect the new macroeconomic environment. The market capitalisation of European incorporated companies has dropped by 35% since the UK's withdrawal from the EU, reflecting a desire from companies within the EU and parts of Central Europe to list within the EU single market. At the same time, other regions increased their share, including Asia (+38%) and Africa/Middle East (+13%), reflecting the increasing growth of those regions from an economic perspective.

Result of the analysis of the 50 largest companies by market capitalisation that left the LSE between 2018 and 2022:

58%

were the result of M&A on market consolidation

26%

were taken private by private equity houses

16%

removed a secondary listing.

Findings

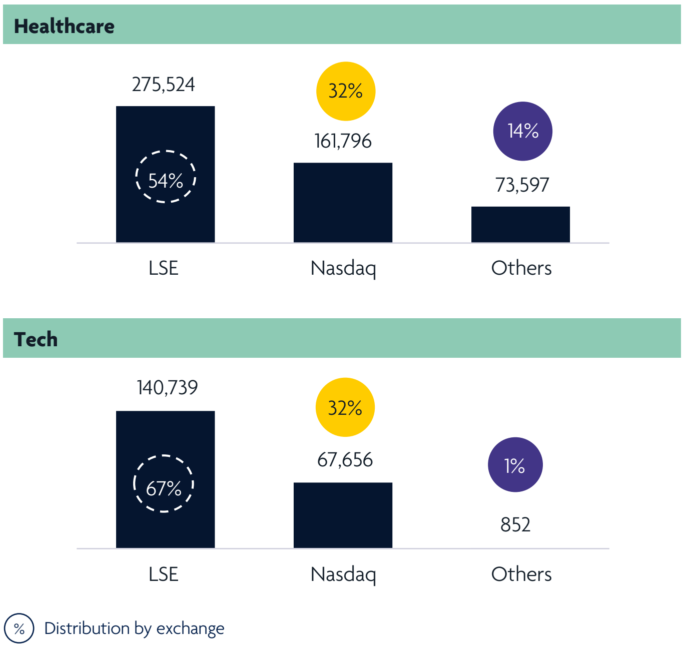
The LSE remains the largest IPO location in Europe in terms of the number of companies joining the public market and the amount of capital raised. The US exchanges have taken a significant market share in both metrics, partly due to the growth of technology companies and the US being perceived as a natural destination for such companies. The LSE remains bigger than the European exchanges regarding market capitalisation and the number of companies that trade on it. However, between 2017 and 2021, the growth rate of IPO numbers and capital raised in Europe has been stronger. This suggests the UK will need to change its approach if it wishes to retain and enhance its position in the context of further macroeconomic changes, market fragmentation and continued technological and innovative changes.

3.3. PERCEPTION 2

The UK struggles to retain and attract growth companies

In 2021, many healthcare companies founded in the UK (46%) chose an exchange outside the UK, predominantly in the US (32%). One-third (33%) of technology companies founded in the UK elected to join non-UK markets, with 32% of the companies choosing an exchange in the US. The two sectors combined account for 35% of all IPO capital raised in the UK in 2021.

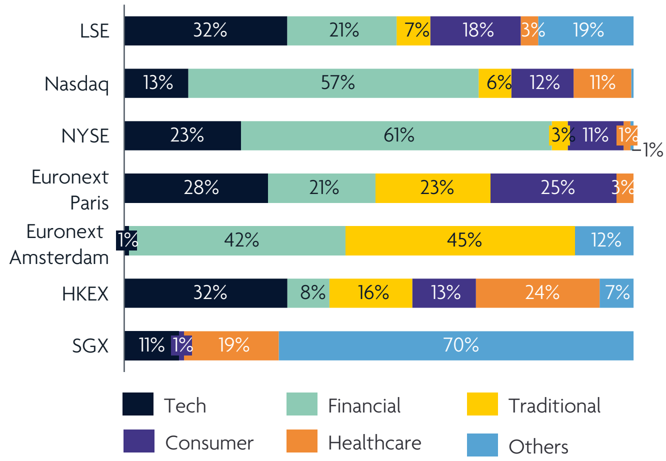
Figure 22: Exchanges on which UK-incorporated healthcare and technology companies are admitted to trading
£mn, market capitalisation, 2021



Source: LSEG, Euronext, Nasdaq, Refinitiv

The UK's attractiveness for technology companies looks even stronger when compared with its European counterparts. While Amsterdam is gaining a reputation for attracting technology sector stocks, with 33% of its total market capitalisation derived from the technology sector, it has only had two technology sector IPOs in the last six years, compared with 16 on the LSE. Technology sector firms represented only 1% of the equity capital raised in Amsterdam in 2021.

Figure 23: Proportion of capital for key sectors across selected exchanges
2021, IPO capital raised



Source: Stock exchanges
Note: Final percentages are rounded up

For **industry sector**, we have leveraged the LSE ICB indicators and grouped them by the following:
Tech = Technology + Telecommunication
Financials = Financials
Traditional = Basic Materials + Energy + Industrials + Utilities (In 2019, 'Oil & Gas' is replaced by 'Energy')
Consumer = Consumer Discretionary + Consumer Staples
Healthcare = Healthcare
Others = Real Estate + Blank values [Real estate was put under Financials sectors up to 2018; we adjusted the LSE dataset to put it under others for better comparability across time and jurisdictions]

Findings

The UK continues to attract technology company IPOs; however, many UK healthcare companies choose other exchanges, typically in the US.

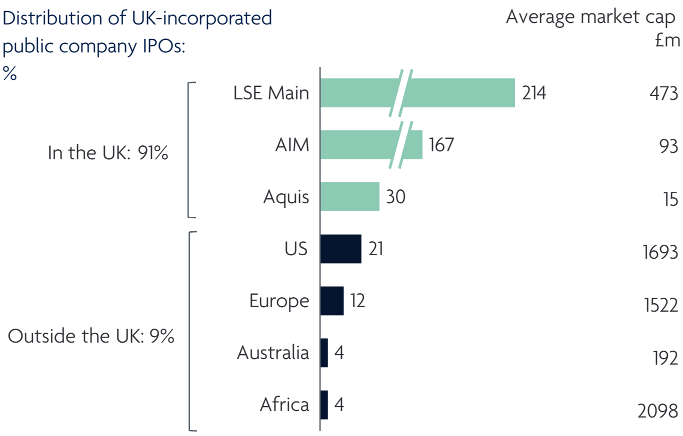
3.4. PERCEPTION 3

Large UK companies choose an exchange outside the UK

91% of UK-incorporated public companies who completed an IPO between 2017 and 2022 selected a UK exchange. Those who chose a US or European exchange had an average market capitalisation of £1.6bn, around four times that of those choosing to remain in the UK.

Figure 24: Location of UK IPOs and average market capitalisation

Absolute value, 2017–22



Source: LSEG, Euronext, Nasdaq, Refinitiv

Findings

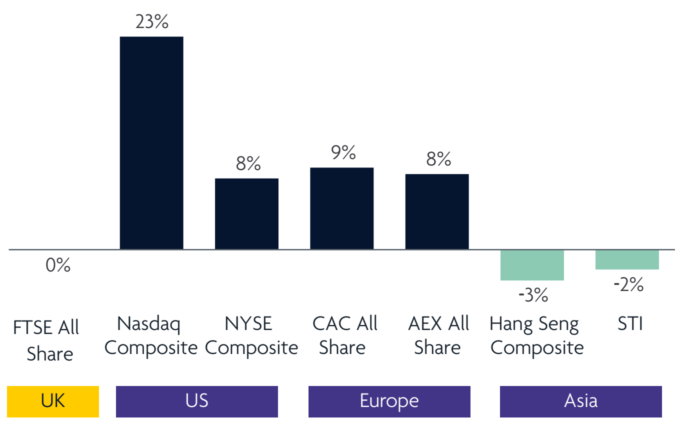
The majority of UK-incorporated publicly traded companies choose to trade on domestic markets. Companies with a higher market capitalisation are more likely to consider an exchange outside the UK than small and medium-sized companies. This might result from various factors such as international profile and sector recognition.

3.5. PERCEPTION 4

Companies trading in the UK suffer from poor share price performance

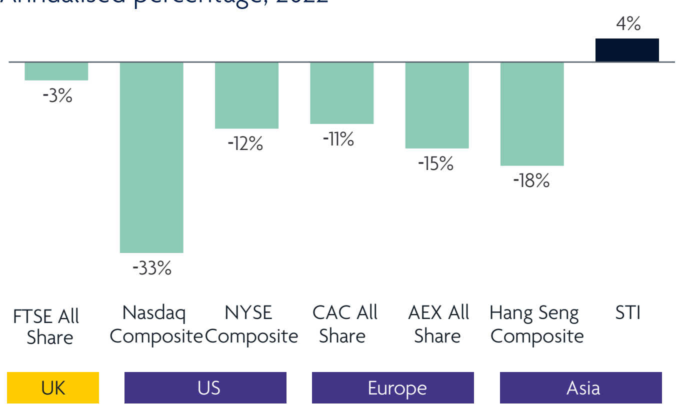
The data shows that the UK equity market underperformed the US and Europe in index price and total return between 2017 and 2021. In 2022, the FTSE All-Share index, which includes many traditional companies, performed significantly better than comparable indexes outside the UK. This shift is largely attributable to high energy prices relating to the war in Ukraine. Once geo-political tensions ease, growth is expected to return to levels seen in preceding years.

Figure 25: Comparison of historical index price return
Annualised percentage, 2017-2021



Source: Refinitiv

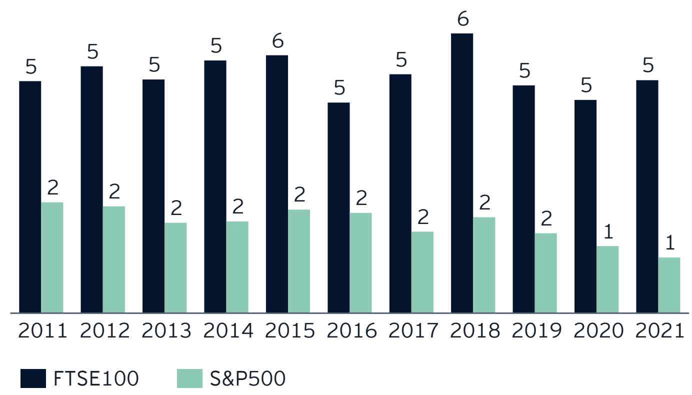
Figure 26: Comparison of recent index price return
Annualised percentage, 2022



Source: Refinitiv

FTSE companies have had higher and more stable dividend pay-outs over the past 10 years than those in the S&P 500, improving total shareholder return (TSR). Share buybacks from the FTSE 100 amounted to 29% of dividends (compared with 154% for the S&P 500).[48,49] The gap remains in terms of TSR – which was 5.5% for the FTSE 100 vs. 19% for the S&P 500 between 2017 and 2021.

Figure 27: Dividend pay-out ratio for FTSE100 vs. S&P500
Percentage, 2011–21



Source: AJ Bell, S&P Dow Jones Index

Dividend/Mkt ratio is calculated by the total annual dividend payout by the index covering companies over the index end-of-year market cap.

Findings

UK companies have seen a decline in overall share price performance in recent years, although 2022 saw an improved performance relative to similar companies in comparable markets. UK-traded companies have returned higher average dividends when compared with those in the US; however, this has not compensated for differences in price performance, resulting in lower levels of total shareholder return.

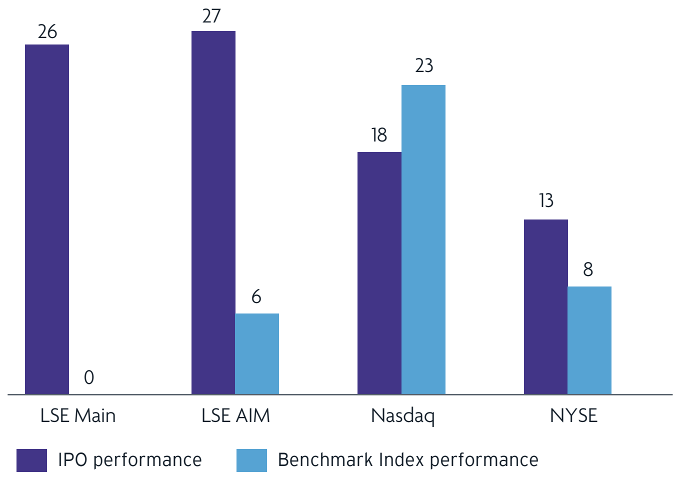
48. Thisismoney.co.uk; average ratio of share buy-back to dividends between 2017-21.
49. Yardeni; average ratio of share buy-back to dividends between 2017-21.

3.6. PERCEPTION 5

US IPOs perform better than UK IPOs, and US valuations are higher than UK ones

There is a significant gap between the index price performance of the FTSE All-Share, the Nasdaq and NYSE Composite (0% vs. 23% and 8% annual growth, respectively, between 2017 and 2021), indicating that US companies, on average, had better price performance. However, LSE IPOs have seen a better aftermarket share price performance than those on Nasdaq or the NYSE, indicating that the latter have seen a downward price adjustment after IPO.[50]

Figure 28: Aftermarket share price performance
Percentage, 2017–21

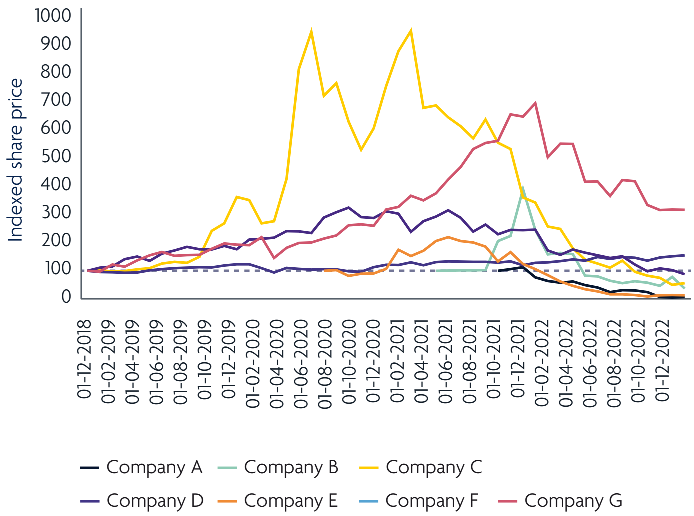


Source: LSEG, Euronext, Nasdaq, Refinitiv

Note: Aftermarket share price performance is calculated using the average of annualised performance (in terms of trading price at 31/12/2021 to the IPO offering price) for all companies that had an IPO in the 2017-21 period.

The experience of UK technology companies admitted to trading in the US also shows that there is no guarantee that performance post-IPO will be better in the US.

Figure 29: Performance of UK technology companies trading on US exchanges[51]
Absolute value, 2018–22

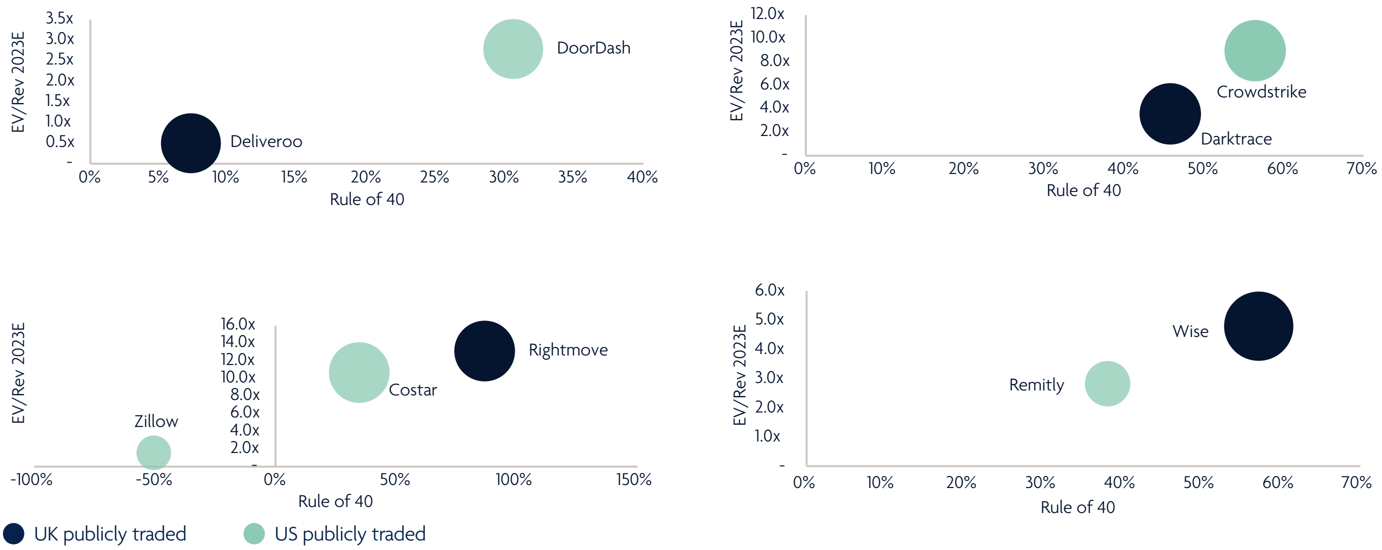


At the end of 2021, UK companies' average valuation multiples (P/E ratios) were below the other jurisdictions covered in this report (15x for FTSE All Shares vs. 20x for NYSE Composite and 33x Nasdaq Composite). The UK was the only market among those covered that had a declining average multiple over the past five years (from 20x to 15x). However, it is important to note the high share of lower growth traditional type companies in the LSE portfolio that will naturally result in a lower overall average multiple.

50. Aftermarket share price performance is calculated using the average of annualised performance (in terms of trading price at 31/12/2021 to the IPO offering price) for all companies that had an IPO in the 2017-21 period.
51. Benchmark indices included: FTSE all share index for LSE, FTSE small cap index for LSE AIM, Nasdaq composite index for Nasdaq, and NYSE composite index for NYSE.

LSEG research shows that when analysing against comparable companies, fundamentals (i.e., growth and profitability of the company) are more influential than market venue in determining valuation.

Figure 30: Example of UK and US publicly traded technology company valuations



Source: Refinitiv, May 2023
Rule of 40 refers to revenue growth (2022/2023E) + EBITDA margin (2023E)
EV/REV refers to the enterprise value-to-revenue. It is calculated by taking the enterprise value of the company and dividing it by the company's revenue.

Findings

While the LSE has lagged behind the NYSE and NASDAQ regarding yearly total returns, it has outperformed in post-IPO price performance. Furthermore, the performance of UK technology sector firms choosing to trade in the US is mixed. The perceived valuation differential between companies traded in the UK and the US is not validated when looking at a group of comparable companies with similar growth characteristics; however, the declining overall average P/E ratio of the LSE is something to note.

3.7. PERCEPTION 6

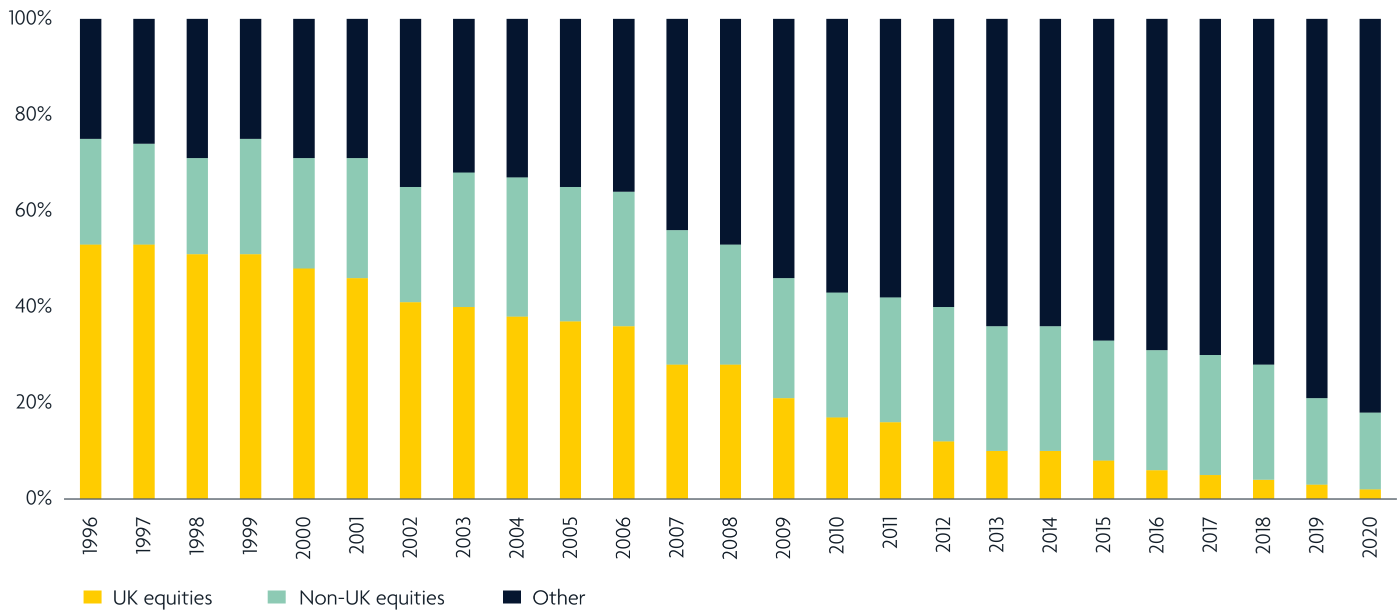
The UK is de-equitising due to a lower risk appetite from investors

There has been a 20-year transition away from investment in UK equities, partly driven by changes in the investment strategy of UK defined benefit (DB) pension funds and changes to the insurance sector's capital regimes.

Recently, DB funds have tended to invest mainly in fixed-income products, a trend driven to a large extent by demographics, i.e., an ageing population covered by DB schemes, hence the shorter expected pay-out timeframes. As the UK has the second highest ratio of institutional funds (including pension funds) to retail clients in Europe (Switzerland has the first), this represents a substantial proportion of capital not invested in equities.

Figure 31: UK DB pension fund asset allocation

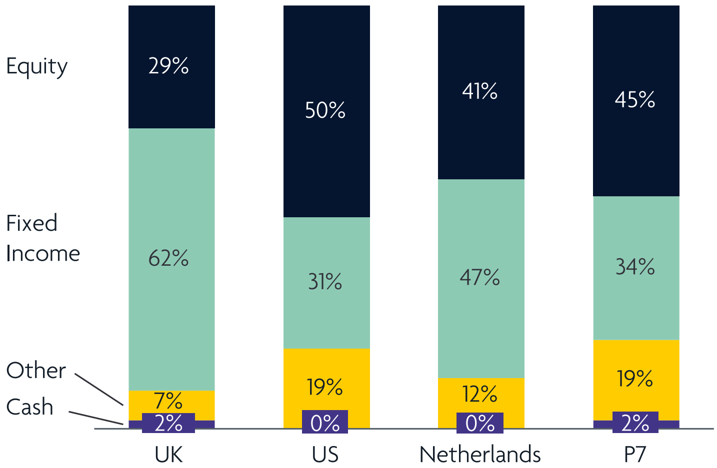
Percentage, 1996–2020



Source: UBS, PPF/TPR Purple Book

In 2021, UK pension funds (including DB and defined contribution (DC) funds) invested around a third of their assets in equities (29%), significantly less than in other leading countries.

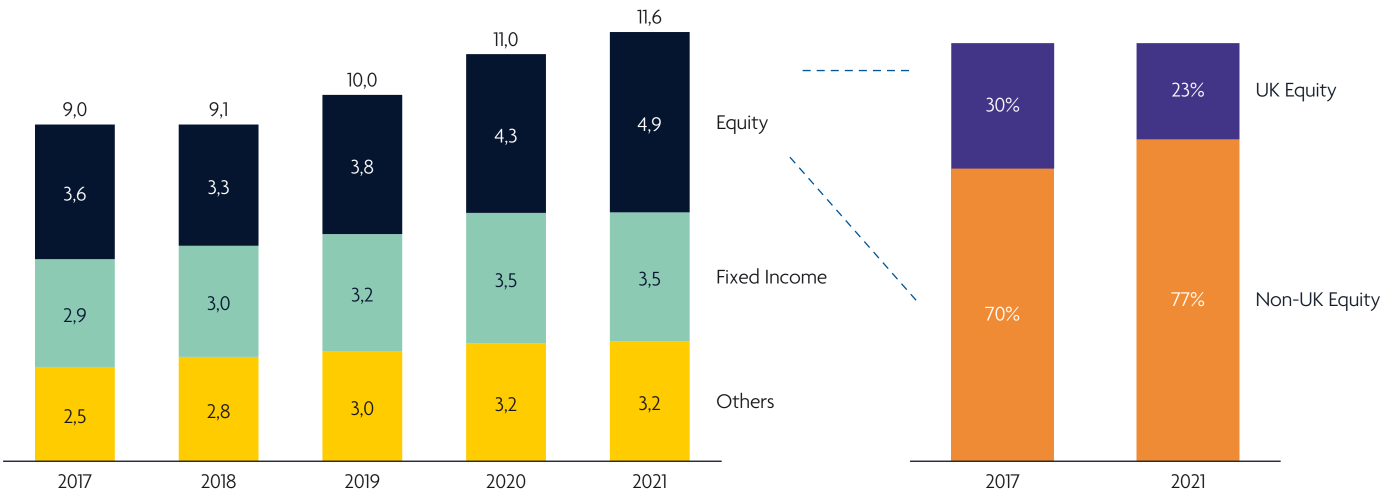
Figure 32: Global pension fund asset allocation
Percentage, 2021



Source: Thinking ahead Institute (Global Pension Assets Study, 2022)

While UK asset managers allocated a higher percentage of their mandate to equity investments from 2017 to 2021 (40% in 2017 to 42% in 2021), the proportion of this invested in UK equities dropped significantly, from 30% in 2017 to 23% in 2021.

Figure 33: UK asset managers' asset allocation and equity allocation into UK and non-UK equities
£tn, 2017–21

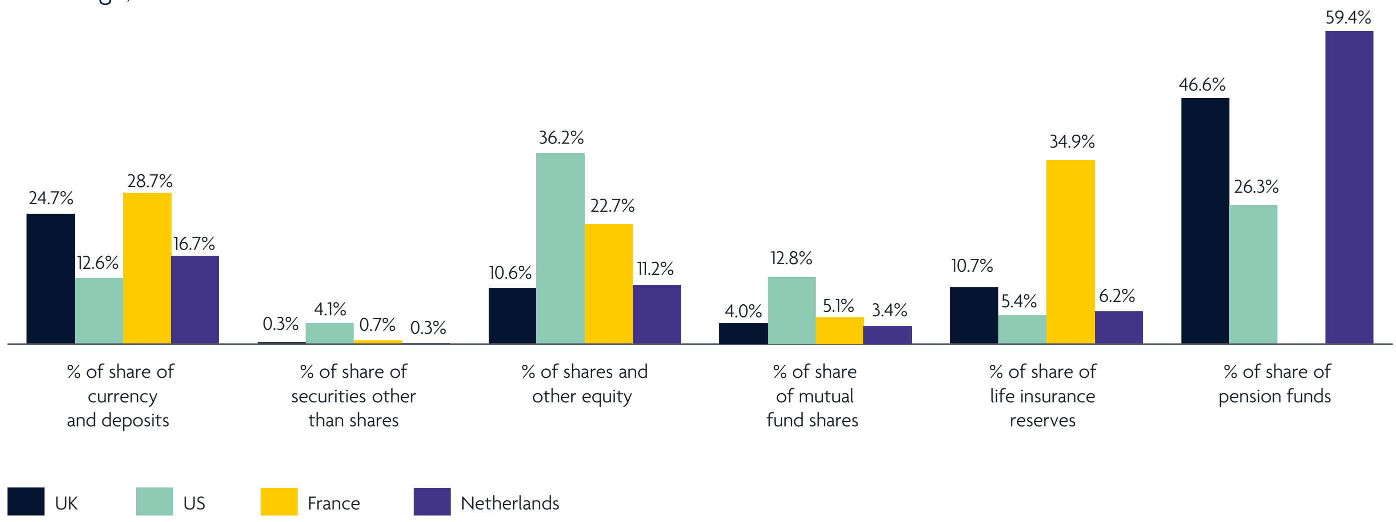


Source: Investment Association
Note: Final percentages are rounded up

UK households hold 10.6% of their financial assets in equity, compared with 36.2% of US households and 22.7% of French households.[52]

Figure 34: Household financial assets

Percentage, 2017–21

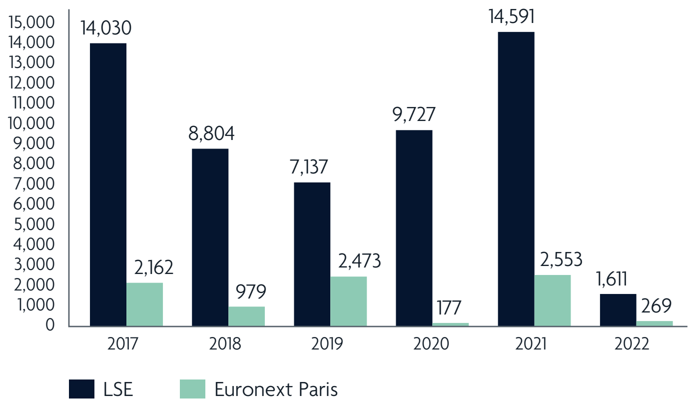


Sources: OECD

Despite the various trends referenced above, £14.6bn of new capital was raised on the LSE in 2021, substantially higher than the next highest European exchange, Euronext Paris, which raised £2.6bn.

Figure 35: IPO capital raised

£mn, 2017–22



Source: Stock Exchanges

Findings

When assessed against historical trends and international comparators, institutional investors, including UK pension funds, invest less in equities, specifically UK equities. This gap is compounded by low levels of retail participation. Despite the declining share of UK equity investments by UK domestic institutional investors, equity capital raising in the UK has increased from £14bn to £14.6bn from 2017 to 2021, funded in large part by overseas investors.

52. OECD

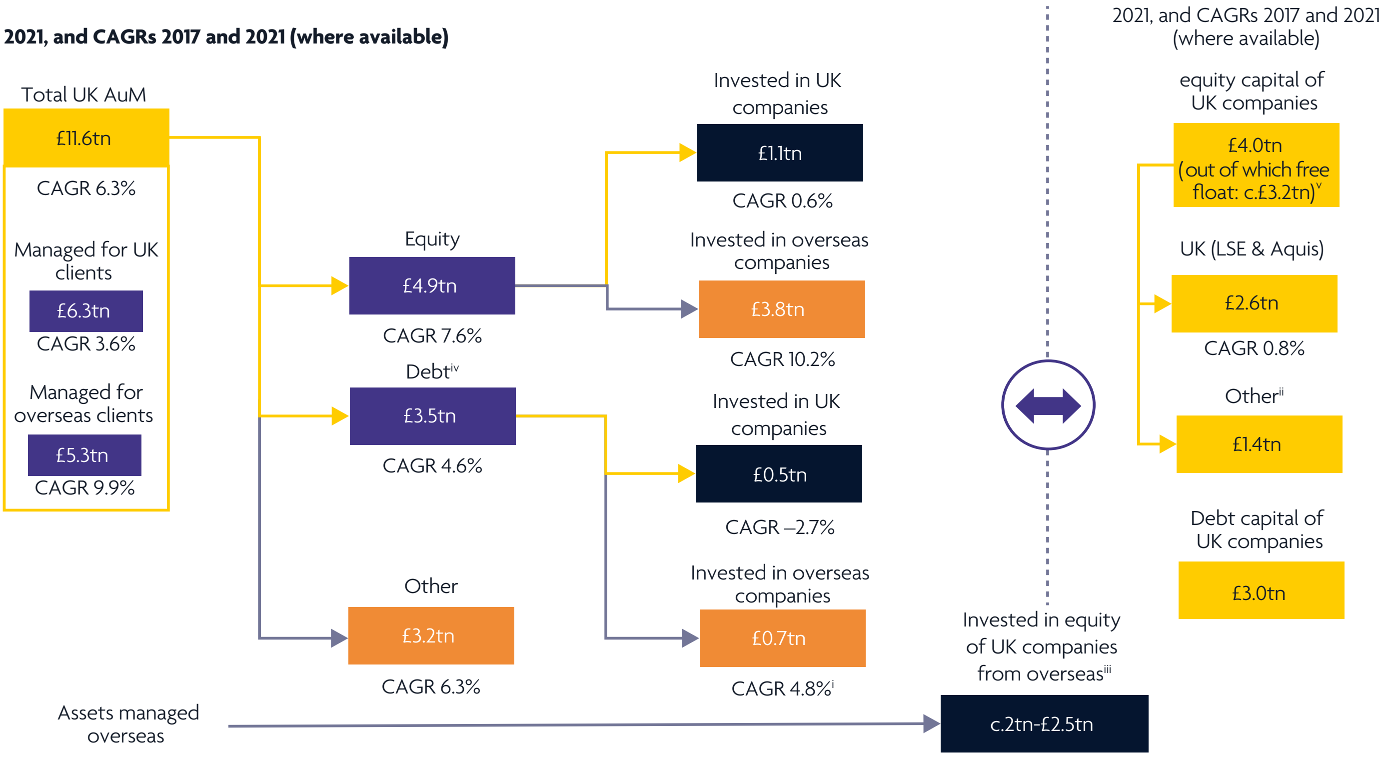
3.8. PERCEPTION 7

UK companies struggle to source equity capital in the UK

As of 2021, UK-incorporated publicly traded companies (wherever traded) had £4tn of equity. Of this, only £1.1tn was provided by UK investors, despite UK investors allocating £4.9tn to equities globally.[53,54] The gap is being met by overseas investors with an appetite for UK equities.[55]

Figure 36: Capital invested in UK equity capital markets vs. capital raised by UK companies

£tn, CAGR 2017–21, 2021



Source: Investment Association, London Stock Exchange, Aquis, Euronext, Nasdaq, Frankfurt Stock Exchange, BIS

i. CAGR for capital invested in overseas corporate bonds is from 2019 to 2021 due to data availability.

ii. Includes market capitalisation of UK-incorporated companies listed on NYSE, Nasdaq, Euronext, and Frankfurt Stock Exchange at end of 2021.

iii. Estimate for amount of international capital invested in the UK, considering that 62% of LSE institutional investors are overseas investors.

iv. Total debt includes corporate bonds, government bonds and others. Only the corporate bonds (£1.2tn) component has been decomposed further.

v. Average free float rate for companies listed on LSE Main Market is c.80% as of end of 2022.

Findings

UK-incorporated companies can raise equity capital, but this is not necessarily raised through the medium of a domestic exchange using UK-based investors. A significant proportion of the capital required by UK companies is provided through other means. For example, capital raised by UK companies on overseas exchanges amounts to circa £1.4tn in total. A further circa £2.5tn was raised by UK companies through domestic exchanges but from international investors who also support UK companies with capital through private markets. It is also worth noting that 39% of the UK's AuM is invested in international companies. For domestic companies looking to join the UK markets, there needs to be a strong pool of domestic capital to complement the international investor capital the UK is already successful in attracting.

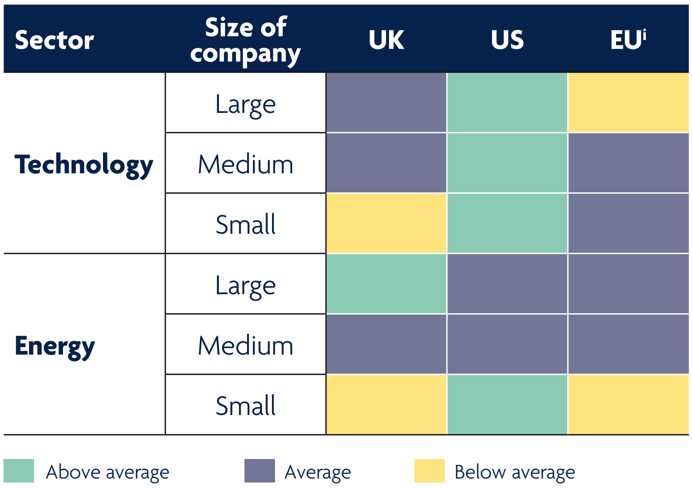
53. London Stock Exchange
54. Investment Association
55. Ibid

3.9. PERCEPTION 8

US capital markets provide more liquidity than the UK

Analysis through a sampling approach, including representative sectors from the 'old economy' and 'new economy,' found that technology companies, especially small-cap companies sub $500mn trading in the US, have greater liquidity than those in the UK. Large technology sector firms have deeper liquidity in the UK than in Europe. For traditional energy companies, the research highlighted that UK liquidity was relatively deep for large caps, while the US has comparatively deeper liquidity for small caps.

Figure 37: EY liquidity analysis across the UK, US and EU
Bid-ask spread, 2018–23



Source: Refinitiv, MarketAxess
i. Includes Paris and Amsterdam

Findings

There is deeper liquidity in the US than in the UK, but the UK generally still provides deeper liquidity than EU markets. It is worth noting that behind the averages, numerous factors influence liquidity, e.g., index inclusion and the company's location – i.e., small UK or EU technology firms choosing to trade in the US will not necessarily experience deeper liquidity.

CHAPTER 4

Market participants' sentiment of UK equity capital markets

4.1. OVERVIEW

Consistent themes are emerging across UK equity capital markets participants

Recent reforms to UK equity markets and the ongoing FCA reform agenda focus predominantly on legislative and regulatory changes. Non-regulatory factors, which often drive market practices, are equally important to the success of markets and are far harder to influence.

Through qualitative research from in-depth interviews and surveys across the market, we have identified some key themes from the perspective of a broad array of market participants, including pre-IPO companies, publicly traded companies, investors, advisers, investment managers and infrastructure providers. Even if some of the themes expressed here are hard to empirically reference or support with hard evidence, they are important indicators of the perceived reality of market participants and decision-makers.

- Companies: Many factors influence a company's decision on whether to join the public markets, including:
  - Their approach to scaling, including the sources of scale-up capital and its future impact on strategic decision-making.
  - Identifying appropriate investors with appropriate attitudes to risk and navigating media and press scrutiny when preparing to trade publicly.
  - Concerns regarding operating in a publicly traded environment, such as the costs and the requirement to meet new regulatory obligations.
  - The ability to invest for growth whilst meeting investor demands on profitability and capital returns, including dividends.
  - Access to liquidity and capital flows.

- Investors: Asset managers, pension funds, private capital and retail investors face differing challenges, including:
  - Structural dynamics (the size of the UK market), pricing, the focus on costs and regulatory factors impact investment choices.
  - Financial education, which remains an important driver of active participation.
  - A need for a pipeline of good quality and exciting IPOs.
- Ecosystem: Those working across capital markets, including investment banks, law firms, accountancy firms, and infrastructure providers (e.g. alternative trading venues and technology platforms), opined that:
  - Markets need to support technology companies better for the UK to attract more overseas companies.
  - The UK's withdrawal from the EU can be an opportunity for the UK, but divergence with the EU also brings risks, especially given the global nature of UK markets.
  - The increased use of technology and innovation will reduce the cost of access to both primary and secondary markets and improve the participation of smaller companies and investors.
  - Early-stage companies can benefit from a diverse market structure that allows for a range of primary venues, supporting transparency and wider reach.

4.2 ABOUT THE COMPANIES

Pre-IPO companies

Scale-up capital required for growth

The research found that the ability to access the capital needed to scale-up and grow is central to informing a company's strategy when considering joining the public markets.

The UK creates the greatest number of businesses per capita in Europe (one per 12.5 versus one per 17 in France and one per 25 in Germany).[56] However, the survival rate of newly founded businesses after five years was only 38% (in line with Germany but well below France).[57] Companies felt that whilst seed and early-stage capital was accessible, including through government-incentivised schemes, e.g., the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS), accessing scale-up capital after that was difficult.

Companies highlighted the increasing reliance on international sources of capital, especially private capital (either venture capital or private equity) and the more risk-reward-focused institutional capital, to obtain the necessary capital required for growth. The desire for venture capital and private equity to take board seats, enabling them to influence the strategy of portfolio companies, was considered significant, especially for future liquidity events, including at IPO.

> **"UK companies have a lot of confidence in being able to grow at an early stage; it is the scale-up stage that becomes problematic."**
>
> Private company

> **"It would be good to develop early-stage infrastructure to avoid looking for US venture capital support."**
>
> Law firm

56. Office for National Statistics and government websites
57. Eurostat

The capital gap is an opportunity for UK institutional capital, e.g., potentially DC pension funds, to support companies to scale. It is estimated that pension funds currently contribute approximately £0.2tn to this cohort per annum, accounting for only around 3% of required funds.[58]

Companies cited that the recent reforms to R&D tax reliefs, including the SME additional deduction rate reducing to 86% from 130%, the SME payable credit rate reducing to 10% from 14.5% and refocusing R&D relief towards innovation in the UK had the unintended consequence of potentially transitioning them away from the UK.

> **"While lots of government grants and tax incentives are available for small companies, especially at early stage, they are not a predictable source and may lead to cliff edge situations."**
>
> Private company

> **"Fiscal incentives are common in other European countries, not as much to attract international companies, but to retain their own companies. France is a good example where Macron is keen to attract and retain French FinTech."**
>
> Publicly traded company

Beyond scale-up capital and fiscal incentives, companies felt that government could play an active and supporting role in achieving operating scale and traction, especially through tender processes and procurement.

> **"In the US, there are laws that mandate the government to buy from small companies, minority-led or minority-owned, and therefore support sales and a key funding source for these companies."**
>
> Private company

Preparing to join the public markets

Companies highlighted that increasing innovation is enabling new business models to be established, and this is reflected in the key sectors forecast to drive GDP growth between 2021 and 2025, namely technology (31.9%), financials (27.6%), consumer (27.2%) and medical and pharmaceutical (19.8%).[59] Respondents expressed concerns that UK equity research coverage was not specialised enough to effectively analyse these new business models. Comparable companies used for benchmarking were at a lower valuation than company expectations, and the opportunity to raise the profile of these new sectors to investors was lost.

The UK has 5,000 equity analysts, the highest in Europe but lower than the 30,000 in the US.[60] Of those 5,000 equity analysts, 721 focus on the technology sector, eight times fewer than the US's 6,741.[61] While these differentials reflect a considerably larger market in the US, there was a feeling amongst some market participants that the introduction of MiFID II has impacted research coverage.

Additionally, the number of analysts, their tenure and experience levels have also reduced. It is estimated that European brokers and banks have lost 3,074 years of experience (as a combination of the number of analysts and average tenure) since MiFID II came into effect.[62]

> **"The US doesn't have just technology analysts; they have sub-sector deep analysts, e.g., blockchain and AI."**
>
> Investment bank

> **"Research is not reaching the broader ecosystem and is not widely accessible anymore."**
>
> Investment bank

58. EY analysis based on McKinsey – Private markets rally to new heights, McKinsey Global Private Markets Review 2022
59. Oxford Econometrics
60. Refinitiv; sell side equity analysts data for the UK, as of Dec 2022
61. ibid
62. https://www.tradersmagazine.com/news/research-lost-7500-years-of-experience-since-mifid-ii/

Companies cited their experience of the difficulty of obtaining scale-up capital from UK investors and investment from UK investors at IPO.[63] Companies felt that there was a lack of traditional cornerstone investors compared with Asia, who could champion IPOs and facilitate follow-on offerings; 92% of respondents felt that the UK had a conservative culture and mindset, resulting in an investor base that lacked diversity and dynamism.

> **"In the US, the culture is different, and they admire ambition. They are just happier with success and growth."**
>
> Private company

> **"While Britain offers lower costs and lower securities litigation, as well as more certain price discovery, the American market has much more depth and liquidity, and crucially, the growth investors that the UK is lacking."**
>
> Publicly traded company

> **"Looking at Scandinavia or Switzerland, local investors just turn up, both retail and institutional. [Unlike in the UK] they are there at the IPO, then follow and back companies."**
>
> Investment bank

Concerns around the UK investor base were pervasive from several perspectives – 90% of respondents felt the investor community in the US was better for growth-orientated companies, as UK investors were perceived to be largely interested in capital returns, including dividends.

> **"We have so much growth to fund, and I don't want to get hammered by conservatively minded investors for the investments we make instead of focusing only on the profitability of the core business."**
>
> Private company

> **"UK investors are not ambitious; they don't want to invest in growth as they don't see the value in future pay-outs versus dividends."**
>
> Investment bank

Companies felt that the lack of diversity and dynamism of the UK investor base resulted in short-termism and an overt focus on risk, which had hampered their ability to execute strategic objectives, including attracting post-IPO talent.

> **"The remuneration report is absolute madness, as you need to pay to get the right people."**
>
> Law firm

Companies cited the requirements and expectations to operate as a publicly traded company were significant from 'Day 1', and there was a need for additional support from exchanges and advisers to prepare and undertake the transition effectively. It was noted that the broader UK infrastructure was centralised, with the exchanges and nominated advisers (Nomads) based in London and companies in other regions lacking support.

> **"It is like being expected to graduate immediately, whilst yesterday you were still in the nursery."**
>
> Private company

> **"You can't apply the same rules to a mid-cap as to a FTSE 100 company."**
>
> Investment bank

> **"We used to have 42 regional exchanges; that is now all centralised."**
>
> Infrastructure provider

A 'nursery' type environment would alleviate concerns about cliff edge expectations, providing a 'glide path' for companies to grow into their status as a publicly traded company.

63. A cornerstone is an investor who commits to buy a fixed amount or percentage at any price across the range when the price range is announced.

Some companies highlighted that their perception of the approach and attitude of the media had an oversized influence when considering whether to join the UK markets, with certain companies stating that their approach was to join the UK market in 'stealth mode' to avoid the news cycle and potential negative public sentiment.

> **"The media in the UK tends to be 'glass-half-empty', and that is not easy to address ... the culture in the US has more patience."**
>
> Private company

There were concerns from non-UK companies, particularly those from emerging markets, about their ability to engage UK investors and the difficulty in satisfying the necessary due diligence requirements. Others, especially small companies, highlighted insufficient support to deal with cross-border legal and regulatory complexities.

Publicly traded companies

Operating in a public environment

Companies cited the considerable cost of being publicly traded, including costs associated with governance and reporting, undertaking audits, and the need to establish specific committees. For smaller companies, the cost was estimated at over £0.5mn per year, factoring in professional service fees.

> **"Regulation is the result of good intentions, but it is complicated in practice when moving from private to public due to governance that aims to protect the system rather than the company."**
>
> Investment bank

> **"The price of being public is significant, and the requirements are daunting for smaller companies."**
>
> Law firm

Additionally, smaller companies raised the complexity of the IPO process and considered that it was a significant distraction from focusing on the core business.

> **"Getting listed is a tedious process, but not worse [in the UK] than on Nasdaq ... you need to be good enough, and if it takes longer, it takes longer."**
>
> Publicly traded company

> **"The listing process is distractive and takes your eye off the ball."**
>
> Publicly traded company

Ability to invest for growth

Most publicly traded companies on the LSE interviewed for this report highlighted that their ability to execute a growth strategy was hampered by investor expectations of capital returns, including dividends. Dividends paid by FTSE 100 companies are five times higher than S&P 500 (adjusted to reflect total market capitalisation).[64] Some companies cited that pre-IPO concerns to attract talent and compensate appropriately to deliver future growth had resulted in special structures to overcome remuneration challenges.

> **"Dividend-focused investors are hampering the ability to invest and grow."**
>
> Publicly traded company

> **"Compensation practices need to change, as international companies need to pay in line with US peers to be able to attract the right talent."**
>
> Publicly traded company

Maintaining liquidity and accessing capital flows

Several companies felt a lack of liquidity in their equity and found it difficult to continue accessing existing investors and/or bring in new investors. The EY analysis highlights that liquidity is less healthy for small-cap companies,

64. EY analysis of AJ Bell, S&P Dow Jones Index data.

including in the UK. However, there are differences across markets. For example, small biotech firms in Amsterdam have two-to-three times higher bid-ask spreads.[65] Several UK companies who chose to trade on other markets, such as in the US market for potentially greater liquidity or in Amsterdam for ease and simplicity, have further suffered due to the distance from their home market.

> **"Small and mid-cap fund managers are providing less liquidity as they are less active than they used to be."**
>
> Investment bank

> **"Listing in the US is not a one-way ticket to success. A lot of companies have become orphans, with no affinity with that market and have lost the attention of investors."**
>
> Investment bank

Companies highlighted that those not admitted to trading on the LSE Main Market lost out on index investors and accordingly had lower capital flows and lower research coverage. Although passive investors are not actively trading, index inclusion is still perceived to be highly beneficial to liquidity and provides visibility and profile for the company. The analysis shows, on average, that the liquidity of AIM-traded companies is significantly worse than those trading on the Main Market.[66]

> **"Once you are in the FTSE 100, your capital will keep going up. The fundamentals are not reflected in the value allocated to you."**
>
> Investment bank

> **"A technology index, even if synthetic, would support visibility and clustering of growth companies."**
>
> Private company

4.3. ABOUT THE INVESTORS

Asset managers

Respondents highlighted structural dynamics, including the size of the UK market, the perceived lack of quality companies, the influence of venture capital and the criticality of after-market liquidity as key factors contributing to their investment decisions.

The size of the UK market was a key consideration driving appetite for risk. The number of UK IPOs in 2021 was 140 (126 LSE, 14 AQSE) compared with 1,056 in the US.[67] AuM in the UK represents 29% of AuM in the US (£11.6tn to £40tn).[68] Of UK-managed equity AuM, only 22% is invested in UK equities (£1.1tn compared with £4.9tn in total).[69] Asset managers referred to a necessity to meet the needs and expectations of 'end customers', which could limit their ability to take risks.

> **"UK fund managers have a different risk profile due to the volume of capital available for them to invest. While a US fund manager may have 50–100 IPOs per year to invest in, a UK one might have only 5."**
>
> Investment bank

> **"There is relentless pressure on meeting your benchmarks; exploration comes with 'hit and miss, and needs a longer-term view than quarter-to-quarter."**
>
> Investment manager

65. Refinitiv; EY analysis based on a sample of 102 companies across five stock exchanges and three sectors.
66. Ibid
67. LSEG, Nasdaq Stock Exchange, New York Stock Exchange.
68. BCG; Global asset management 2022
69. Investment Association, LSE, Aquis.

UK investors felt that there had been a lack of new, good-quality UK IPO candidates in recent years, and the perception of international investors was that the UK could do more to support innovation that, in exchange, would attract capital.

> **"We have seen very few exciting UK IPOs for years. When there is one, everyone wants to get an allocation of the same company."**
> Investment manager

Respondents suggested that early-stage and growth companies may prefer venture capital and private equity as strategic partners to other early forms of financing, as they can provide the support required over the longer term.

> **"[US] venture capital money is a popular route to market, as the venture capital owner can effectively help to scale."**
> Investment bank

The importance of understanding aftermarket liquidity was raised, especially when investing in riskier regions or companies. Respondents mentioned government-backed schemes to ensure liquidity post-IPO as a potential solution that has worked well in other countries.

> **"Initiatives from exchanges where they can talk about an IPO fund and can cornerstone an IPO and support aftermarket liquidity has resonated very strongly with a lot of issuers."**
> Investment bank

Pension funds

Regulatory considerations, attitude to risk, the convoluted value chain around pensions and the current political focus on activating pension capital were all raised as factors impacting investment strategy.

The impact of recent proposals regarding the pension fee cap and performance fees were cited as positive steps in the right direction; however, this would not address the structural issues in the market.

> **"Regulation on the pension fee cap is not the issue, but competitive dynamics are."**
> Investment manager

There was broad agreement that a lack of motivation exists around risk-taking, including engagement and empowerment of the end customer (policyholders). UK households hold 10.6% of their assets in equities, a third less than US ones and half the amount French households invest.

> **"We haven't created 401k style pension plans and corresponding engagement."**
> Investment manager

> **"There are a couple of areas where younger generations are actively expressing interest, such as crypto, ESG (e.g., energy transition), that can be potentially leveraged."**
> Investment manager

There were concerns that pension funds were in danger of being told when and where to invest based on the broader political discourse for greater investment into equities by pension funds.

> **"Uncertainties in the UK market make it unattractive for pension funds to get in, and they should not be forced."**
> Investment manager

Private capital funds

Interviews with venture capital and private equity funds highlighted that the exit strategy used to achieve the relevant fund returns was the overriding factor when considering a liquidity event. The ability to execute that strategy was also influenced by where the fund was domiciled, timeframes for achieving a liquidity event and the ability of new investors to understand the private equity business model related to debt and leverage.

Respondents commented that an exit via public markets is not the primary exit strategy currently. Private equity firms typically seek a 'complete exit' from the relevant asset. The exit approach and the increasing trend for private equity firms to invest in complex assets means that an M&A route (including a sale to another private equity fund) is more attractive, especially given the process and time to market on an IPO. Between 2017 and 2021, only 11% of private equity exits were IPOs.

> **"Our businesses are typically not the vanilla businesses that are easy to price. We need sophisticated investor money."**
>
> Private equity

> **"We cannot afford the extra time that the LSE and FCA require from a company with a complex financial background [compared with some European exchanges]."**
>
> Private equity

Private equity firms also highlighted the leverage of portfolio companies and the requirement for market depth and commented that US exchanges are more comfortable with high leverage.

> **"Our businesses are 6x–7x leveraged; we need the proceeds from IPO to pay down debt. It is difficult in European markets. In the US, it is easier to exit."**
>
> Private equity

Critically, when private equity considered an IPO exit, exchanges that provided the greatest immediate gain through valuation, with the so-called 'IPO pop', were most attractive.

It was also noted that a large amount of private capital is locked up due to market developments in 2022 and not being 'recycled' to support new companies, as PE companies face challenges to exit. Companies tend to use private capital longer, meaning that the focus and capital allocation are moving from early-stage towards later-stage.

> **"Early-stage capital should go back to early-stage investment."**
>
> Publicly traded company

Retail

Interviews with technology solution providers and other platforms highlighted the challenges in enabling individuals' ("retail") seamless and cost-effective access to public markets. At the same time, feedback showed that there was a perceived need to simplify messaging and financial education if markets are to be more accessible to them. However, there was also the reflection that a range of investment vehicles that cater for the different needs of investors (including SIPPS, ISA variations, EIS, SEIS and EMS) is required to be maintained going forwards.

> **"Retail investors don't have sufficient understanding to participate in equity and bond markets, as they lack understanding of the products."**
>
> Investment bank

Interview participants have identified several potential benefits to retail participation. Individuals behave differently to institutional investors, potentially contributing to market diversity. Adding in additional retail investors was also highlighted as a way of creating more market depth They are also perceived to contribute to better price discovery and liquidity, given broader views and different investment motives.

Some interviewees observed that during the 2020 COVID-19 crisis, the liquidity provided through retail investor participation in some equity capital markets helped the recovery of those markets, and this view has been further supported by research studies.[70] In an environment where other investors were exiting the markets due to regulatory and internal risk management requirements, retail investors could step in by purchasing shares and thereby supporting companies. These interviewees observed that improved retail investor participation will benefit the capital markets and enable long-term wealth creation for individuals, an imperative in an environment where pension schemes are moving away from defined benefits to defined contributions resulting in individuals having to take greater personal responsibility for saving and investing.

For example, in the US and France, 10% of the IPO offer amount is typically made accessible to retail investors.[71] In the UK, however, those who interviewed felt cultural aversion, legal concerns and technological limitations provide friction to investments.

> **"While [a global investment manager firm] may sell all your stocks the next day after the IPO if the price is up, a retail investor will feel ownership and stick around for 5-10 years."**
>
> Trading technology provider

> **"While in the US it is absolutely common, in the UK raising capital from retail is seen as having trouble accessing institutional capital."**
>
> Publicly traded company

An estimated £3.9tn of UK investor assets are in cash deposits and cash ISAs.[72] Participants said that an element of these cash balances could be reallocated to support UK equity capital markets. However, this will need to happen step by step.

> **"Savings account holders will not want to jump into IPOs right away – they will need to be supported in their journey of investing through buying bonds, (passive) ETFs and individual stocks on the secondary market first, to gain confidence."**
>
> Trading technology provider

Interest in trading on the secondary market is increasing. The Freetrade and Vanguard UK platforms gained over 1mn and 400,000 customers in the past five years, respectively.[73] Even the incumbent Hargreaves Lansdown is growing at a yearly rate of 13%, reaching close to 2mn users with an average invested amount of £100,000.[74] However, the US surpasses the UK in scale – Robinhood alone had 23mn funded accounts at the end of 2022.[75]

> **"Scale and adoption is still behind the US where there are multiple trading accounts per person."**
>
> Investment bank

70. World Economic Forum; 'Future of Capital Markets: Democratisation of Retail Investing- Insight Report August 2022': During the 2020 COVID 19-related stock market drop, the presence of retail investors buoyed the market, leading to a quick recovery through the provision of liquidity.
71. PrimaryBid
72. Investment Association
73. Freetrade and Vanguard
74. Hargreaves Lansdown
75. Robinhood

4.4. ABOUT THE ECOSYSTEM

Interviews with a range of key advisory functions which support equity capital markets, including investment banks, law firms and accountants, to understand whether the sentiments raised by companies and investors resonated with those who facilitate equity capital raising. Most advisers commented that the points raised by companies and investors were consistent with their understanding.

Investment banks

Investment banks highlighted regulation and change, investor mindset and emerging business models and markets as key areas of friction.

The recent regulatory changes following the UK Listings Review, including reducing the minimum free float to 10% and the changes permitting certain dual-class shares, were called out as positive influences on a company's choice of market. Respondents commented, however that many recent changes were iterative and more transformational changes were required. There was a sense that the UK now has an opportunity to move away from EU regulation. However, many also saw that divergence as a potential risk. It was felt the UK would need to work hard to stay competitive, given potential reforms in the EU.

> **"[rules] have become easier and more flexible; but still not enough of a difference to make a strong difference to list in the UK instead of Europe."**
>
> Investment bank

> **"We shouldn't spend time on developing products and adapting to new regulation if the impact delivered is minimal."**
>
> Investment bank

> **"The UK could benefit, for example, from a more purposeful pre and post transparency regime. It has the ability to be more agile than the EU as they need the compromise of 27 regulators."**
>
> Investment bank

Investment banks felt that the UK equity capital markets had not adapted to the change to new business models, especially those that were asset-light and more intellectual property (IP)-driven, as quickly as other markets and, as a consequence, had been less able to capitalise on the transition to the new economy sectors.

> **"Technology companies find the City conservative and are looking for like-minded peers, investors and advisers, including lawyers and accountants who understand their business."**
>
> Investment bank

Emerging markets and broader geopolitical considerations were seen as an opportunity for the UK to reorientate itself and maximise on trends. These include the increase of IPOs in the Middle East and navigating the approach with China and the UK's relationship with the US.

> **"Aligning with the US is an issue when having business with China. The scrutiny of the SEC follows even after delisting."**
>
> Law firm

It was felt that the UK was in a position of strength regarding secondary markets, with market-leading infrastructure and technology. However, accepting cultural change could restrict further growth and innovation.

> **"It is hard to improve the existing ecosystem. The market is strong, very well connected, people know each other, but at the same time, these people are resisting change."**
>
> Investment bank

Law firms

Law firms highlighted the need for companies to receive holistic, unbiased advice to support the decision-making process, which wasn't always considered to be the case. Companies appeared to have predefined perceptions of the benefits of a particular destination.

> **"The softer factors have been lost against valuation and liquidity … need to bring them more to the forefront so people can make a holistic decision."**
>
> Law firm

Common themes were the complexity of the experience, that regulation was over-emphasised and the progress from recent reforms not fully appreciated. It was also felt that companies underestimated the complexity of US regulation and that the media narrative on the ease and upside of joining exchanges outside the UK contributed to decisions on where to trade.

> **"Regulation in the UK is not as bad as is made out versus other markets. In Hong Kong, the process is very invasive, litigation issues in the US are consistent, and in Sweden, there is a high degree of regulations."**
>
> Law firm

> **"We are not in a good place in terms of perception. Companies are pulling out of the market based on what they are hearing in the press."**
>
> Law firm

Accountancy firms

Accountancy firms highlighted the structural shift away from equities as a key factor, which had been exacerbated by attitudes to and perception of risk. It was felt that the regulators' stance on risk management policies for the investment management industry was often interpreted with risk-based outcomes, e.g., the concept of value for money, which was driving a focus on costs.

> **"We need to illustrate to policymakers the relatively low risk associated with equity in a balanced portfolio of investments versus gilts."**
>
> Accountancy firm

Some firms expressed concerns about the lack of AIM's success in providing a stepping stone to the Main Market. It was commented that founders enjoy distinct tax reliefs on AIM, which fall away on a move to the Main Market. It was suggested that if the loss of this relief were tapered, this would encourage more 'step-ups'.

> **"AIM has not proven to be a successful feeder to the Main Market."**
>
> Accountancy firm

CHAPTER 5

Analysis of sentiment

5.1. OVERVIEW

Clear consensus on the strengths and areas for attention for the UK equity capital markets

The interviews and the surveys highlighted important themes and insights on how market participants view the different aspects of the UK capital markets.

These sentiment themes and insights were structured to better understand the following:

- The most important decision factors, as well as differences between various types of companies.
- The key strengths and areas for attention for UK capital markets.

The approach used to analyse market sentiment has followed three main steps:

- Identifying seven distinct company types.
- For each company type, identification of the main decision factors related to the use of an exchange.
- Identification of the strengths and areas for attention for the UK capital markets – by integrating the qualitative and quantitative data analysis.

Overall, there has been a level of consistency among the market participants on the critical factors when considering where to trade. By order of importance, and across the different types of companies, these factors were as follows:

- Access to a strong investor base
- Valuation and research coverage
- Liquidity
- Comparable companies
- Ease and cost of being publicly traded

Key nuances were identified across the different types of companies. For example, small, high-growth US and international companies expressed a preference to join the AIM market in the UK – as US markets were inappropriate due to their size and eligibility and continuing obligations requirements. For this type of company, the ease and cost of trading publicly was a strong deciding factor. For most other company types, the access to a strong investor base was considered the main decision criterion.

This market sentiment analysis combined with the quantitative analysis has also highlighted the key strengths and areas for attention of the UK capital markets.

- The key strengths include: The UK has a deep capital pool, a large research analyst base, a considerable level of liquidity and a wide range of companies.
- The key areas for attention: Despite the deep pools of capital and the reasonable level of liquidity, certain companies find it difficult to access capital and grow. Continuing obligations requirements and the sponsor regime seem onerous and distracting for some.

5.2. ANALYSIS OF COMPANY TYPES

To evaluate the broad range of issues and perspectives gathered from market participants, the data was structured by creating seven different types of companies that utilise UK equity capital markets. These groups provide additional insight into how the characteristics of the companies, e.g., size, sector, stage of development and location, impact their requirements. Additional characteristics of ownership structure and leverage have also been used.

Figure 38: Preferred location by company 'types'

		UK-incorporated companies			International companies			
		A	B	C	D	E	F	G
		Small domestic-focused UK companies	Medium high-growth UK companies	Large international-focused UK companies	(Small) European companies	(Traditional) Non-European companies	Companies that are secondary listed international	Small high-growth US/international companies
Preferred market		UK	UK/US	US	Europe	UK/HK/US	US/UK (Secondary)	UK – AIM
Type	Size	Small	Medium	Large	Typically Small	Medium	Large	Small
	Business coverage	UK	International	International	EU	Regional	Global	US
	Growth rate	Any	High-growth	Medium growth	Medium growth	Any	Medium growth	High-growth
Further company Insights		• Typically owned by founders and management (who will continue to lead firm post admission), moderate growth ambitions, profitable and cash generative business	• Typically high-growth (e.g. tech/health) firms which are (foreign) VC/ PE owned, with owners looking for an exit	• Typically firms still having further growth potential, have strong follow on capital needs, have a global business, management team/talent pool	• Companies, typically from Eastern Europe looking to move beyond their home markets, with moderate capital need	• Companies, typically traditional, from Central and Eastern Asia, without mature and liquid home markets	• Major international firms that are looking to boost liquidity and reputation through a secondary listing	• Small companies (incl. Canada, US), seeking equity funding but too small to trade in the US due to listing regulations

Notes:
i. Observations refer to the interviews and surveys with companies , as well as inputs from advisors discussing certain company type.
ii. Methodology: Both interviews and surveys have been utilised to devise the rankings, and observations from both companies and advisors have been used. The first step consisted of ranking the importance of these dimensions at an individual level (after undertaking either an interview or survey for each company or advisor) – survey candidates were prompted to make a ranked selection from a list of 15 criteria, while interview candidates were asked about their priorities and tested on the most commonly listed items by survey participants. The second step consisted of taking all the dimension score for companies in the same type and summing them together to create an overall ranking for each company type. The dimensions of importance were then chosen and ranked above.

Companies were asked to rank the critical factors they consider when assessing the strength of an exchange. The top five results were consistent, regardless of the type of company:

- **Access to a strong investor base:** access to sophisticated investors with an understanding of the sector and business models.
- **Valuation and research coverage:** access to specialist research analysts with appropriate depth of knowledge to be able to provide insights for investors.
- **Liquidity:** sufficient market volume in the aftermarket, index eligibility and turnover of indices.
- **Comparable companies:** the presence of companies from the same sector or with similar business models on the relevant market.
- **Ease and cost of being publicly traded:** complexity and cost of the process, driven by regulatory, accounting and disclosure requirements, and availability of support during the process.

While there was consistency on the top-ranking issues, it should be noted that other responses highlighted considerations that were more specific to the type of company – resulting in a longer and more nuanced list of critical factors.[76]

Three most notable differences emerged from this exercise. Firstly, governance was the top issue for large internationally focused UK companies (type C) but not in the five top factors for most other company types. Secondly, liquidity was much less of a factor for UK companies than international companies. Thirdly, small and medium companies are more concerned by the ease of the process.

Figure 39: Top 5 listing decision criteria by company 'types'

		UK-incorporated companies			International companies			
		A	B	C	D	E	F	G
		Small domestic-focused UK companies	Medium high-growth UK companies	Large international-focused UK companies	(Small) European companies	(Traditional) Non-European companies	Companies that are secondary listed international	Small high-growth US/international companies
Preferred market		UK	UK/US	US	Europe	UK/HK/US	US/UK (Secondary)	UK – AIM
What are the Top 5 decision criteria for company type when assessing the strength of a stock market?	Rank 1	Access to a strong investor base	Access to a strong investor base	Governance matters	Valuation/ research coverage	Liquidity	Liquidity	Ease and cost of being publicly traded
	Rank 2	Valuation/ research coverage	Valuation/ research coverage	Access to a strong investor base	Access to a strong investor base	Stability	Reputational considerations	Access to a strong investor base
	Rank 3	Ease of process	Ease of process	Valuation/ research coverage	Liquidity	Access to a strong investor base		Liquidity
	Rank 4	Geographical relevance	Liquidity	Reputational considerations	Governance matters	Diversity of ecosystem		Reputational considerations
	Rank 5	Liquidity	Comparable companies	Comparable companies	Geographical relevance	Comparable companies		Valuation/ research coverage

Note: The colours represent the same criteria across the company type columns.

76. Additional criteria definition: **Reputational considerations** (external factors that can impact a company's reputation, e.g., the attitude of the press/media), **Geographical advantage** (growth opportunities in the company's home market or new markets), **Governance matters** (Practices regarding the executive remuneration and a company's corporate/board structure), **Stability** (Refers to a country's economic and political stability), **Diversity of ecosystem** (Ability for an ecosystem to provide a broad range of products and services to its market participants. E.g., the sophistication of products, accessibility of pre- and post-IPO services).

The company types also had differing preferences on location. While small companies, both domestic-focused (Type A) and US or international (Type G), see a substantial benefit from trading in the UK, medium high-growth UK companies (Type B) and large international-focused UK companies (Type C) more often choose another destination. Having a UK presence is still important for some non-European companies (Type F), while EU companies (Type D) may prioritise locations within the EU.

Figure 40: Number of companies per company type that trade in the UK or elsewhere

		UK-incorporated companies			International companies			
Company types:		A	B	C	D	E	F	G
	Total sum of companies across types	Small[ix] domestic-focused UK companies[i]	Medium[ix] high-growth[ii] UK companies	Large[ix] international-focused UK companies	(Small) European companies	(Traditional) Non-European companies	Companies that are secondary listed international	Small high-growth US/ international companies
Preferred market		UK	UK/US	US	Europe	UK/HK/US	US/UK (Secondary)	UK – AIM
Companies traded on the LSE	1902[viii]	1355	15	89	100	235[v]		110[vi]
Companies IPOed on LSE (from 2017 to 2022)	467	352	7	6	15	58		29
Companies that have migrated to other exchanges (from 2017 to 2022)[iii]	161	28	4	4	51[iv]	NA	NA	74[vii]

Notes:

i. Number of all UK-based AIM and small Main companies used as a proxy for type. Listed on LSE from end of 2022 LSE issuer list: AIM [704] and small Main [651]; UK-incorporated companies that IPOed on LSE from 2017 to 22: AIM [167] and small Main [185].

ii. For high-growth companies, technology and healthcare sectors have been used as an approximation.

iii. Estimated based on global IPOs as tracked by LSEG, for 2017 to 2022 period.

iv. Number includes cross-country listings of EU companies on Euronext [15] and EU companies traded in the US [36]. Excludes companies that have listed on their domestic market or on other locations.

v. Non-EU companies include North America (114), Asia (56), Australia (29), Africa (12) , Latin America (3),and Middle East (19).

vi. All non-UK based companies on AIM, including North America (52), Europe (27), Asia (5), Australia (20), Africa (1), Latin America (1) and the Middle East (4).

vii. Companies from outside EU listed on Euronext Growth [1] + Micro foreign companies traded in Australia [73]. We defined micro companies as companies with market cap below £200mn.

viii. Unclassified companies: 161. They might behave as company type A, B or C based on their individual characteristics.

ix. For analysis of the company types, the following size definitions are being applied: "Large" companies defined as market cap above £4bn, "Medium" companies as market cap between £1 and 4bn, "Small" companies as market cap below £1bn.

5.3. SENTIMENT ON THE STRENGTHS OF UK EQUITY CAPITAL MARKETS AND AREAS THAT REQUIRE ATTENTION

Combining the qualitative sentiment from interviews with the quantitative data from surveys and the rankings of different market participants, many strengths of the UK equity capital markets have been identified. Similarly, there are areas that require attention.

Company perspective

Access to a strong investor base

- Strength: In aggregate, the UK is perceived to have deep pools of capital and significant market liquidity compared with European financial centres.
- Areas for attention: The benefits of these capital pools were not necessarily felt by all companies. In addition, the UK has a conservative investor base with limited risk appetite and a preference for capital returns, including dividends, over supporting growth.

Valuation and research coverage

- Strength: The UK has a large analyst and research base providing coverage of the mid and large segments of the market. Coverage predominantly focuses on traditional business models, with limited pockets of specialist coverage of emerging sectors, e.g., renewable energy.
- Areas for attention: There is a lack of independent research coverage for smaller companies and a limited number of research analysts for high-growth sectors. Companies felt this impacted the profile of specific sectors and contributed to a lack of investor understanding and appetite to invest.

Liquidity

- Strength: The UK is considered a highly liquid market, especially for companies on the Main Market, with index inclusion more predictable than the S&P 500.
- Areas for attention: Small and mid-cap fund managers provided lower levels of liquidity as they are less active, which impacts the companies in this segment.

Comparable companies

- Strength: UK markets have more comparable companies in traditional sectors, including manufacturing and natural resources, than other European markets.
- Areas for attention: High-growth companies are adversely impacted by a lack of appropriate comparable companies in the UK markets.

Ease and cost of being a publicly traded company

- Strength: The robustness of the process required to join public markets is respected. AIM provides a lower entry threshold with a relatively straightforward admission approach. Underwriting costs in the UK are considered to be moderate compared with the US and Asia. Litigation risk is also lower than in the US.
- Areas for attention: Some view the sponsor regime as onerous, distracting and unduly complicated, especially for non-UK companies. The system does not cater for complex scenarios, e.g., managing the impact of US SEC regulation for US-domiciled companies. For smaller companies, the cost of being public is significant, and the requirement to comply with all continuing obligations immediately on listing is challenging. The transition from AIM to the Main Market is not straightforward and creates friction. The FCA published proposals in May 2023 to establish a single Main Market listing category for equity shares in commercial companies. A more flexible, disclosure-based approach to eligibility and continuing obligations is proposed together with modifications to the role of the sponsor.[77]

77. https://www.fca.org.uk/publications/consultation-papers/cp23-10-primary-markets-effectiveness-review

Investor Perspective

Market efficiency and infrastructure

- Strength: The UK has a mature market infrastructure. Specifically, secondary market infrastructure is viewed as world-leading due to intermediary technology.
- Areas for attention: In the UK, infrastructure that can support early and growth-stage private companies is considered less mature and is relatively limited. Non-US platforms operate on significantly lower volumes than US ones, e.g., Forge and Nasdaq Private Market. However, there are live initiatives in the UK currently assessing solutions such as an intermittent trading venue (ITV) to bridge private and public markets.

Quality of companies

- Strength: High regulatory standards, including disclosure requirements, provide assurance that UK companies are well-managed and appropriate for investment.
- Areas for attention: There is a perception that high-growth or high-potential companies' decisions to join overseas exchanges resulted in domestic exchanges accommodating less attractive companies.

A pipeline of new companies

- Strength: Many new companies are created in the UK compared with other markets, underpinned by strong talent and a spirit of entrepreneurialism.
- Areas for attention: Impact of private capital (i.e., companies staying private longer or taken private after flotation) and associated exit strategies impact on the decision on whether and when to seek a public listing.

Diversity of investment opportunities

- Strength: Opportunities are available across all sectors, including companies at various sizes and stages of their lifecycle.
- Areas for attention: There is a perception that the UK does not have scale in certain sectors, and it is difficult to find a sufficient number of 'exciting' investment opportunities that are worthwhile to invest in.

CHAPTER 6

Recommendations to support UK capital markets

6.1. OVERVIEW

Action needs to be taken now to build on the market's strong foundations

The information presented in this report shows that while the UK equity capital markets have strengths, there are four areas where enhancements need to be made to ensure our markets are better equipped to continue to serve the economy in the decades to come:

- Companies need more help to access growth-stage funding, especially those companies that require investors to remain invested for a specific duration (so-called patient capital).
- More capital could be unlocked from institutional and retail investors and invested in UK equity.
- Frictions in the system should be removed to drive further efficiencies.
- The benefits of joining and investing in the UK should be celebrated, and those willing to invest and grow in the UK should be supported and championed.

The recommendations cover both targeted 'quick wins' and the need for further market change. Together they form a package that could help optimise the UK markets for the future. These recommendations are put forward in the spirit of further debate and should be considered alongside other initiatives that look to enhance the competitiveness of UK capital markets.

6.2. DIAGNOSTIC

The data identifies current factors and developing market trends that, without intervention, will put the UK's market on a downward trajectory. It is time to move from ideas to action to secure the fundamental long-term health of the UK's markets.

Four distinct but interrelated themes have been identified, noting that some issues are not new; however, their persistence in 2023 demonstrates they remain outstanding, and more work needs to be done.

SMEs need more help accessing UK capital markets

Feedback pointed to the fact that small and medium-sized UK-based companies find it challenging to obtain appropriate funding and support at certain stages of their growth lifecycle. If left to continue, this will hinder the future depth of UK capital markets and their overall attractiveness to investors. Based on data and survey feedback, we provide four tangible illustrations of the challenges facing smaller companies:

- Some companies struggle to obtain the support they need to help with R&D-related investment initiatives following recent changes to tax credits.
- New and emerging businesses find it difficult to secure investors who understand their business model and future potential. This is especially true for niche and new subsectors and technologies.

- There is a perception that the path to becoming publicly traded is too complex. This deters companies from joining public markets, as they are concerned that they will need significant additional resources and that management will be distracted from running the core business.
- The 'cliff-edge' expectation of having to operate on Day 1 as a publicly traded company, with no 'glide path' to ease into significant new obligations and duties, was a particular concern.

UK capital does not always reach UK companies

The UK's approach to investment is driven by both structural factors (such as accounting and regulation) and cultural factors (a desire for return rather than longer-term growth). The result has been a sharp drop in the capital invested in UK equity. The data-gathering exercise demonstrated that:

- UK investors prioritise capital returns, including dividends, over the patience needed for longer-term returns in growth companies.
- 90% of participants (across all cohorts interviewed) felt that the investor community in the US is more supportive of high-growth companies.
- Historical changes to insurance rules and pension reforms resulted in lower relative equity holdings.[78]
- UK households, on average, hold significantly less (10.6%) of their financial assets in equity than comparable countries.[79]
- Public market participation is not culturally embedded in the UK.
- In 2021, UK investors invested £3.8tn in non-UK equities.[80]

Collectively, these factors are stifling the capital available to UK markets – especially for small and medium companies with high-growth potential. In contrast, there is a perception that US VC markets have 'deeper pockets' and are more willing to support small companies through their early lifecycle to IPO.

Too much friction disrupts capital flows

The UK can do more to further simplify and streamline operational processes. This would ensure an optimal flow of capital between domestic and international investors and companies. Some areas of friction in the system include:

- The burdens placed on companies by manual and duplicative processes are costly and out of place in a digital world.
- The cost and time needed to manage the obligations that apply to publicly traded companies (such as governance and reporting) are seen as onerous and disproportionate.
- MiFID II unbundling rules have led asset managers to scale back on the number of research providers they use. Breath of stock coverage – particularly at the smaller end of the market – has suffered as a result. Additionally, the changes introduced in 2018 to facilitate a broader range of investment research on IPOs have not resulted in a marked increase in research and have introduced an additional week of potential market risk into the IPO launch timeline.
- Frictions in the transition process from AIM to the Main Market hamper the ability of companies to 'step up'.

The UK's profile is suffering

The UK has an opportunity to redefine how it showcases itself to global market participants. Currently:

- Some respondents considered the public discourse disproportionately focussed on corporate failure rather than championing success. This was viewed in sharp contrast to the 'pro-business' environment in the US.
- Respondents also noted the focus on relative senior-level pay and remuneration in the UK and its subsequent impact on hiring and retaining global talent.

78. Powerful Pensions; unlocking defined contribution capital for UK tech growth.
79. OECD
80. Investment Association

6.3. RECOMMENDATIONS

One of the aims of this report is to prompt debate. It is critical to adopt a collaborative and cooperative approach in order to improve UK markets. The recommendations in this report are not presented as comprehensive; they are practical and aspirational actions that, collectively, can move the dial.

Some of the actions build on existing ideas and initiatives. Other suggestions are more transformative and originate in direct response to the needs identified. These recommendations are intended to prompt further debate and engage key stakeholders to strengthen the UK's position as a market of choice in the decades ahead.

Recommendation 1: Address the structural challenges hindering UK growth companies

There is a need to scale-up UK Limited to UK PLC and help support UK SMEs' understanding of their path to becoming publicly traded companies. The core action is harnessing the convening power of government and industry to share ideas, challenges and opportunities to help maximise the growth and potential of UK companies.

When defining timing, the following has been assumed: short-term actions to be tackled within a year, medium-term ones within two to three years, and long-term ones in three years or beyond.

Action 1.1 R&D incentives: Provide larger, sustained R&D tax breaks for targeted sectors. Such incentives should be structured over a long enough period (e.g., 10 years) to provide companies with clarity across the investment cycle. The provision of greater incentives to UK-incorporated companies trading on a UK market should also be considered.

Key stakeholders: HMT/HMRC; Timing: medium-term.

Action 1.2 Improve investment products to help companies scale and grow. Examples include:

a Schemes to encourage investment already exist; however, their current scope should be expanded. The scope of investment under the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS) should be extended into regulated entities, for example, regulated fintech businesses. Enterprise management incentives (EMIs) should be included alongside the SEIS to eliminate an 'incentive cliff edge' for scaling companies.

Key stakeholders: HMT/HMRC; Timing: medium-term.

b. Consideration should be given to tax policies that incentivise companies to continue to grow and ultimately join UK markets. For example, any public money paid via tax schemes could be repaid if a company chooses an exchange outside the UK within 10 years of receipt of the relevant funds.

Key stakeholders: Government, HMRC; Timing: short-term.

c. The UK could develop fund structures to support companies on their growth journeys and channel more domestic capital into UK equities. By way of example, this could be achieved by:

- The introduction of 'growth funds' that are privately funded (i.e., by attracting money from DC pension pots) and focus investments on early-stage companies and or target sectors. The development of the Future Growth Fund, being led by the City of London Corporation, will be an important initiative in this regard.
- Cross-over funds which support companies on their journey from private to public. The investment strategy of these funds would be to take private companies through a public process and remain invested, acting as a cornerstone investor.

Key stakeholders: HMT, HMRC, City of London Corporation, market participants; Timing: short-term.

Action 1.3 Establish a 'Web Summit'-style annual conference in the UK. This would enable the government and regulators to listen to the challenges and opportunities from both UK-traded companies and candidates that could join public markets in the future in a more informal conference-style environment suited to seeking feedback on sentiments and perceptions on how UK markets are serving UK businesses. Other stakeholders, such as infrastructure providers, advisers and investors, could also be involved in such a gathering.

Key stakeholders: DBT, HMT, stock exchanges, trade bodies; Timing: short-term.

Action 1.4 Provide a glide path to becoming a traded company and beyond. The obligations publicly traded companies are required to comply with are a significant step for a company previously held privately, meaning that a 'bridge' to the public markets and additional support in their early life as a traded company would be beneficial. A proposal for an 'intermittent trading venue', enabling shareholders in privately held companies to trade shares on set days, is already under consideration. Expected new rules implementing HMT's proposals to reform the prospectus regime include provisions aimed at encouraging companies to disclose future financial information (e.g., forecasts). This expected relaxation of existing requirements may provide companies choosing to go public with another way to tell their story to the market.

Regulators and market operators should establish a more formal communication channel with newly traded companies to help them through at least their first six months as a publicly traded company.

Less burdensome requirements on moving from a growth market to the Main Market should also be considered. Collectively, the in-flight initiatives and suggestions mentioned above will act as a bridge to support private companies looking to transition to public markets.

Key stakeholders: HMT, FCA, stock exchanges, trade bodies; Timing: medium-term.

Recommendation 2: Reboot the nation's culture towards financial empowerment and entrepreneurship

The perception of the UK as a conservative market where high-growth firms struggle to gain attention needs to be addressed. Actions should focus on strengthening the image of the UK as a positive destination of choice for companies and where they will find a dynamic and supportive investor base. Changing this narrative will require a cultural shift toward valuing high-growth 'patient' investments, complemented by changes to the regulatory and structural frameworks that restrict equity investment.

Action 2.1 Education and engagement: Empower individuals to take personal ownership of their financial future:

a. Early engagement: Emphasise the importance of investing for the future (the concept of no risk, no reward, the power of compounding and the benefit of starting to invest early) from an early age is key to increasing financial empowerment. This needs to be in accessible formats that can engage a young audience, e.g., via traditional and social media. Some examples of this are already happening, such as the City of London campaign on Financial Literacy.

   Key stakeholders: Department of Education; Timing: long-term.

b. Speaking to schools: Linked to 2.1.a, create industry-supported events in schools to educate the next generation on the importance, where appropriate, of saving and investing for your future. This could include:

   - Workshops after SATs in England and an equivalent appropriate time in the devolved nations to educate children on the benefits and methods of investing any disposable income and how to recognise potential frauds or scams.

     Key stakeholders: Department of Education; Timing: long-term.

– School-based talks by successful start-ups and other local success stories could improve children's understanding of business, the balance of risk and reward and the path to success. Talks could also cover the basic purpose of the capital markets so that children understand the positive and enabling role of capital in society (they provide the funds to help companies grow and to support them in their retirement).

  Key stakeholders: Department of Education; Timing: long-term.

– Engaging children aged 16 to increase their knowledge of saving vehicles, such as junior ISAs, pensions and what to do if they have junior ISA maturing at 18.

  Key stakeholders: Department of Education; Timing: long-term.

c. Raise awareness and engage educators: Delivery of the above recommendations will require the support and backing of educational leaders. The 'All Party Parliamentary Group on Financial Education for Young People report' found that two-fifths of teachers, who have a statutory duty to deliver financial education, were not aware that it is a national curriculum requirement. Raising awareness of this is important given that financial education is a life skill which can have significant positive impact on children and young people's future financial wellbeing and social mobility.

   Key stakeholders: Department of Education; Timing: short-term.

d. Start early and build: Drive long-term investment appetites and individual responsibility via early exposure to investment products and tools, e.g.

– An education campaign to raise awareness about the benefits of investing in JISAs and similar products. The planned HM Treasury and FCA review of the financial guidance and advice boundary could consider how more support can be provided to individuals to encourage greater utilisation of the available products and to ensure that informed decisions deliver an appropriate mix between cash and equity investing.[81]

  Key stakeholders HMT; Timing: medium-term.

– Making the gilt market more accessible to individual investors, e.g., through a digitised gilt supported by a government marketing campaign.

  Key stakeholders: HMT; Timing: long-term.

e. Access to other asset classes: A key area of attention should be to progress work on tokenising assets to enable UK citizens to have 'skin in the game' by owning part of UK PLC. Tokenisation allows assets to be fractionalised, making some investments more accessible. For example, this would make it possible for individuals to invest their SIPP in a broader range of assets with just £10 (rather than having to have £100,000).

   Key stakeholders: HMT; Timing: long-term.

Action 2.2 Incentivising UK equity investment: Provide incentives for investors to invest in UK equities:

a. Support equity investment: Encourage the utilisation of the full ISA allowance in conjunction with an education campaign to raise awareness about the benefits of investing in stocks and shares ISAs. The planned HM Treasury and FCA Review of the financial guidance and advice boundary could consider how more support can be provided to individuals to encourage greater utilisation of annual ISA allowances and ensure that informed decisions deliver an appropriate mix between cash and equity investing. Policymakers may also want to consider how ISA policies could be used to support investment in UK companies. Investors should also be able to fund ISAs through "in specie" contributions, i.e., they should be able to 'gift' any shares that they hold directly into a stock and shares ISA.

   Key stakeholders: HMT/HMRC; Timing: long-term.

b. Removing the 0.5% stamp duty on share purchases could help wider participation and secondary market liquidity. Removing stamp duty would reduce the cost of investing, incentivising more investments in equities. HMRC is currently seeking views on the SDRT regime.[82]

   Key stakeholders: HMT/HMRC; Timing: long-term, e.g., apply initially to newly traded companies only.

81. Yearly costing can be done by assessing predicted annual birth rates.
82. https://www.gov.uk/government/consultations/stamp-taxes-on-shares-modernisation/consultation-stamp-taxes-on-shares-modernisation

c. Remove structural impediments to equity investment: Maintain momentum in addressing the legal and regulatory impediments that deter insurance and pension funds from investing in traded equity.[83] Specifically:

   – Defined benefit: Support the ongoing Solvency II reforms to provide broader incentives to back the UK economy. Consider whether there are additional changes that would unlock UK capital from a risk-adjusted reward perspective. While it is unlikely that we will see material investment into UK equities given current regulatory requirements and the underlying demographics of the individuals investing through these schemes, opportunities remain to utilise DB or insurance capital to support UK PLC meaningfully.

     Key stakeholders: HMT, DWP, industry bodies; Timing: short-term.

   – Defined contribution: Support the reforms to fee caps in relation to pension performance to incentivise consideration of higher returns for pension holders. This needs to be aligned with education (action 2.1.a) so individuals are engaged with their pension funds throughout the products lifecycle and better understand risk-adjusted returns and the need to provide patient capital.

     Key stakeholders: HMT, DWP, industry bodies; Timing: short-term.

d. Encourage investors to focus on risk-adjusted, long-term returns, as opposed to cost, liquidity and short-term return.

   Feedback has suggested that there is too much focus on cost and not enough on long-duration risk-adjusted returns. The DC pension reforms seek to address this issue in part by seeking to move performance fees on corporate pensions outside of the default fee caps. This has the potential to support a reshaping of the approach and narrative to investments, aligning interests, and putting the emphasis back on ensuring appropriate investments to support what are, in reality, long-dated liabilities (i.e., ensuring adequate savings for retirement).

   Key stakeholders: UK government; Timing: ongoing DC pension reform actions.

Recommendation 3: Continue to improve 'the plumbing'

Enhancing efficiencies and removing frictions in the system will benefit all users of UK capital markets – companies, investors and ultimate pension beneficiaries. We need to maintain the momentum created by the positive steps taken to date, such as the reduction in the free float requirement and the changes to dual-class share rules, as well as more recent structural proposals to improve the UK's listing regime. This will require positively engaging with the digitisation of UK capital markets and the UK's regulatory reform programme, particularly the FCA's Primary Markets Effectiveness Review and HMG's amendments to wholesale markets through the Financial Services and Markets Bill. To maintain the UK's competitive position, stakeholders need to remain open to further enhancements in the future to accompany and address a dynamic and evolving marketplace.

Action 3.1 Continue to improve information flows in the market. This can be done by:

a. Introducing a more flexible regulatory approach to MiFID II unbundling requirements. It has been observed that the MiFID II unbundling rules have led asset managers to scale back on the number of research providers they use; competition and analyst coverage – particularly at the smaller end of the market – have suffered as a result. Removing the MiFID II requirement on market participants to 'unbundle' research and execution costs and instead applying a broader level of flexibility such that clients have the option to choose how they pay for the research they consume (i.e., on a bundled or unbundled basis), would help to redress this trend and stimulate information flows in the market.

   Key stakeholders: Investment Research Review, HMT, FCA, industry bodies; Timing: short-term.

83. For example, please see the Powerful Pensions, unlocking defined contribution capital for UK tech growth.

b. Exploring with mid-size and smaller research houses their appetite for other market innovations to improve information provision on smaller cap companies or those in target sectors. There have already been some steps to create introductory independent sector notes or calls, and the future outcomes of the Investment Research Review will be important in this regard.

   Key stakeholders: HMT, FCA, industry bodies; Timing: short-term.

Action 3.2 UK index refresh: Revisit and refresh indexation policies to ensure that they remain fit for purpose. In addition, the possibility of new indices should be explored – potentially around specific sectors or high-growth companies, e.g., a UK SME index.

Key stakeholders: Index providers, including FTSE Russell; Timing: align with the ongoing FCA Primary Markets Effectiveness Review outcomes and proposed single listing category for equity shares in commercial companies.

Action 3.3 Harness technology to improve market infrastructure for the benefit of issuers and investors. For example:

a. Full digitisation of the shareholding system, including full dematerialisation (physical to electronic) of the way shares are held. This should include efficiencies in the way that smaller shareholders hold their shares. Additionally, nominees should improve the voting service provided to clients.

   Key stakeholders: DBT, CREST; Timing: in progress/ Douglas Flint Digitisation Taskforce.

b. Permit companies to communicate with their investors solely on an electronic basis so that companies can benefit from email distribution of shareholder communications by default.

   Key stakeholders: DBT; Timing: in progress/Douglas Flint Digitisation Taskforce.

c. Remove the requirement for hard copies of annual reports and shareholder communications. Make physical annual reports available on request.

   Key stakeholders: DBT; Timing: in progress/Douglas Flint Digitisation Taskforce.

d. Allow companies to choose whether to hold AGMs/ GMs entirely virtually, in a blended format, or in-person only, depending on the relevant company's individual requirements.

   Key stakeholders: DBT; Timing: in progress – Douglas Flint Digitisation Taskforce.

Action 3.4 Encourage global investors to vote consistently on key shareholder resolutions across international markets: to ensure that companies can compete for talent on a level playing field.

Key stakeholders: Investor communities and representative bodies; Timing: long-term.

Recommendation 4: Reinforce the UK as a destination of choice

Attracting domestic and global companies and investors to the UK and retaining them once they are here is critical to the success of the UK marketplace. Developing and pitching a new narrative on the future of UK equity capital markets and the benefits of being traded here would benefit the whole ecosystem.

Action 4.1 Develop 'Why choose UK capital markets' content. Develop and promote UK success stories (e.g., a focus on sectors), celebrate home-grown entrepreneurship, and encourage the public to back businesses using UK markets through targeted communications and engagement with the media.

Ensure that audiences have the opportunity to hear UK success stories (including the wider benefit of traded companies, e.g., supporting growth and investment, spreading wealth and employee share ownership) and permeate the public discourse, which tends to focus on highlighting failures. This can be linked to financial education and the need to empower individuals to take personal ownership of their financial future.

Key stakeholders: HMG, DBT, and industry bodies; Timing: immediate.

Action 4.2 Reward companies for choosing to trade publicly in the UK. Publicly traded companies provide wider investment opportunities to institutions and individual investors and value to the UK's economy and financial ecosystem. Their management and strategy are also more transparent and can be seen and gauged by all stakeholders. To encourage companies to take this path, we believe that UK-domiciled companies which choose to trade on UK markets should benefit from targeted incentives to offset the additional costs and regulation applicable to publicly traded companies.

Key stakeholders: HMT/HMRC; Timing: short-term.

Action 4.3 Identify potential 'non-UK company' targets. Proactively reach out to appropriate companies headquartered outside the UK seeking to IPO or undertake a secondary listing to showcase UK market strengths (subject to appropriate due diligence). We can no longer assume that these companies will choose the UK. This approach can complement the existing outreach programmes undertaken by stock exchanges by coordinating with trade bodies and government departments.

Key stakeholders: HMT and other government departments, Industry bodies; Timing: short-term.

Action 4.4 Active support for non-UK companies. Ensure non-UK companies benefit from sufficient support and education on joining UK markets (e.g., understanding UK listing rules and ongoing obligations). For example:

- A proactive communication and advertising campaign could be disseminated at an appropriate time via relevant UK entities, such as the Department for Business and Trade. For example, assuming the IPO market is open, recent and proposed changes to the listing regime/other macro changes would be an opportunity to showcase that the UK is 'open for business'.
- 'Trade envoy' for UK capital markets to join broader UK trade delegations.
- In this context, we note ongoing efforts by the FCA via the Primary Markets Effectiveness Review, which aim to introduce a simpler and more flexible listing regime and widen access to UK equity capital markets to a greater range of companies.[84]

Key stakeholders: *HMT and other government departments, FCA, market participants, listing venues; Timing: short-term.*

Action 4.5 Work towards deference mechanisms. Applying, where appropriate and on a targeted basis, deference mechanisms to reduce unnecessary duplication of legal and regulatory requirements for international companies and companies who trade publicly in more than one jurisdiction. This could build on the recent reforms initiated by Lord Hill's Listings Review.

Key stakeholders: HMT, FCA, stock exchanges; Timing: long-term.

84. https://www.fca.org.uk/publications/consultation-papers/cp23-10-primary-markets-effectiveness-review

CHAPTER 7

A future vision for UK capital markets

7.1. COALESCING AROUND CHANGE

This report has assessed how the UK's capital markets ecosystem is currently structured, and the views and perceptions that may shape its future. Alongside this, we have set out the key challenges that, if left unaddressed, will stifle the future progression and evolution of the UK's capital markets ecosystem and impact how those markets serve our economies. We must keep the momentum and coalesce around change. It is time to harness the most impactful initiatives and innovative concepts that have been put forward by a range of stakeholders into a plan that enables our equity markets and, by extension, our broader capital markets to serve the economies and populations of the future.

Whilst this report does not set out a comprehensive menu or set list of what an evolved UK capital market may look like, it does set out below what the prize might be for overcoming the challenges set out earlier in the report. Having a coherent vision, clear targets, and an understanding of whether efforts are resulting in progress will help steer and positively shape UK markets and contribute to a 2030 vision.[85]

7.2. THE PRIZE

Achieving these outcomes will require the UK to address, through collective action, the four challenges that this report has identified and upon which we have predicated the recommendations.

Companies need more help accessing UK markets

If structural challenges hindering UK growth companies are addressed:

- ☑ More of the innovative start-ups and early-stage companies founded in the UK will be able to scale in the UK and join UK public markets.
- ☑ Early-stage companies will no longer face a 'cliff edge' when they outgrow existing funding schemes and incentives; UK markets can provide the capital and investors needed for their entire lifecycle.
- ☑ Early-stage companies will be able to easily access information and resources to support them in their journey to becoming publicly traded companies.

85. For example, the Finance for Growth initiative, https://news.cityoflondon.gov.uk/leading-city-executives-join-forces-to-map-out-future-of-uk-financial-services-sector/

UK capital does not always reach UK companies

If action is taken to reboot the nation's culture towards financial empowerment and entrepreneurship:

- ☑ A greater proportion of UK capital, both retail and institutional, can be deployed into UK companies and local economies.
- ☑ The decline in the proportion of UK pension fund capital invested in UK equities can be reversed and begin to increase.
- ☑ A national conversation can take place about risk and reward, supported by better financial education, resulting in more people understanding the benefits of taking informed risks and generating long-term returns.
- ☑ UK-managed AuM can continue to grow at 6% and above yearly, and allocations to equity will increase. If just 5% of the circa £4tn cash savings were mobilised, the UK would have an additional £200bn to support UK companies.

Too much friction is stifling capital flows

If the UK continues to improve the plumbing of its capital markets:

- ☑ Small and mid-cap UK companies can be better-covered by specialist research analysts.
- ☑ Retail investors can have greater choice in how they access public markets and play a more active role in supporting the companies they use every day.
- ☑ The UK can move toward a fully digitised shareholding system.

The UK's profile overseas is suffering

If measures are progressed to reinforce the UK as a destination of choice:

- ☑ The UK can not only maintain but increase its share of the global IPO market.
- ☑ The UK can cultivate a positive dialogue around success and entrepreneurship and celebrate that through media, industry, and the government and regulatory sector.

7.3. CONCLUSION

The role of capital markets extends beyond the world of finance and investment and its societal contribution is significant. From job and wealth creation and developing skills and talent, to driving innovation, the criticality of dynamic and well-functioning capital markets to the overall health and prosperity of the UK cannot be underestimated.

UK capital markets are at an inflection point – several reviews and initiatives have delivered beneficial changes. However, the opportunity exists to deliver a vision that builds on the existing strong foundations and achieves the structural change required to remain competitive in an ever-evolving global environment.

The challenges described in this report require all capital markets participants – companies, investors, and the wider ecosystem – to come together with government to create the right conditions for economic growth.

Taking on this challenge of rebooting our capital markets is no small task. Still, the reward is material – a greater source of domestic capital that supports our SMEs and other UK companies, an empowered population with more choices on savings and investments and an international investor base that deploys capital to all corners of the economy. With these fundamentals in place, the UK's capital markets ecosystem and global financial reach can power the UK's economic future.

Table of figures

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