QUOTED COMPANIES ALLIANCE

Are the public markets closing to smaller companies?

The evidence from the past 20 years in London

By Hardman & Co

in collaboration with the Quoted Companies Alliance

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Are the public markets closing to smaller companies?

Why has it happened, does it matter, and what can be done?

There has been much comment on the fact that equity markets in the US and Europe have been shrinking for some years now, certainly in terms of the number of quoted companies, if not in total market capitalisation (MCap). This paper has been written with the assistance of the Quoted Companies Alliance (QCA) and focuses on the evidence for such in the London market and, in particular, that for smaller and mid-cap companies. It assesses that evidence and considers explanations. Finally, we ask why it matters, and assuming that it does, what practical steps can be taken to reverse the trend. Successful public markets have been a key part of the United Kingdom's economic success for generations, even centuries, and we should not allow them to wither on the vine.

We find that:

- The total number of companies quoted on the London Stock Exchange (LSE) actually rose between 1999 (2,257) and 2007 (2,933), before falling back to 1,791 by 2019.
- However, looking at the total number of companies masks an underlying picture of almost continual decline in the Main Market, offset by the extraordinary success of AIM until 2007.
- Since 2007, both markets have seen a decline in the number of companies, the Main Market by 25% and AIM by 49%.
- Excluding the financials, the number of companies quoted on the Main Market has fallen by 60% since 1999. This compares with a 52% decline when financials are included.
- Looking below the largest 350 companies, we find that the number of non-financial companies on the Main Market has fallen by 72% since 1999. By December 2019 the number had fallen to just 252.
- The average MCap of a quoted company outside the largest 350 has risen sharply. Adjusted to 2019 prices, the average MCap of a small cap company has grown from £38.9m in 2008 to £152.7m in 2019 (adjusted for inflation).
- Although there have been ups and downs, the long-term path for the average MCap at Initial Public Offering (IPO) has had a strong upslope. In 2019 pounds, the average MCap has risen from £21m in 1995 to £515m last year (excluding Investment Companies and Glencore's float in 2011).
- The average AIM IPO MCap has grown from £21m in 1995 to £127m in 2019 (again ex-Investment Companies and expressed in 2019 pounds).
- On average, companies leave it much later to "come to market".
- There is plentiful evidence about the reasons behind these trends. A growing regulatory burden, low interest rates making debt attractive and increasing competition from private equity for opportunities are cited as the main factors by companies.

Shrinking markets are bad for companies, the economy and society

We believe that shrinking public markets matter. They are bad for companies, the economy and society. Efficient public markets bring many benefits to companies, such as access to larger and more varied pools of capital, from which we all gain. The success of public companies in raising fresh equity in recent weeks to plug holes caused by the coronavirus lockdown is powerful testament to the utility of public markets.

There are positive steps that can be taken to reverse the trend of de-equitisation

Choking off access to public markets has not been a conscious choice of anyone, but rather an unintended consequence of other actions and trends. All stakeholders, including the UK Government, should consider the steps needed to meet this challenge. We believe that regulation on companies should be rolled back (particularly easing the prospectus rules), pension funds encouraged to re-weight towards growth companies and steps taken to improve liquidity. Companies themselves could help by engaging more with investors through a number of routes. The Government should consider becoming a long-term investor itself. Steps should be taken to ensure that investment decisions in the fund management community are not over-concentrated. Finally, the open offer process should be digitised and sped up.

A greater fragmentation of investment decisions which creates more active decision makers in the SmallCaps, involving retail investors, rather than ignoring them, would improve liquidity. This would go some way towards resolving many problems and help end an environment which increasingly ignores quoted SmallCaps.

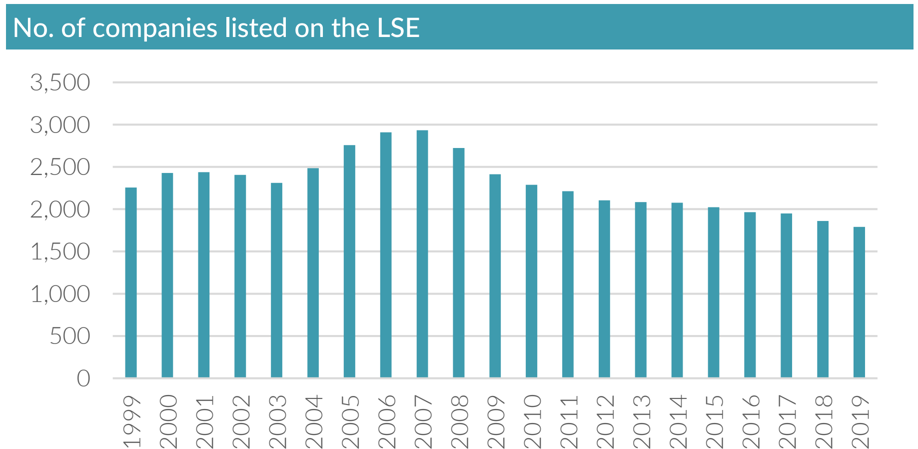
The evidence

The number of companies

The idea that the public markets are shrinking and not working for companies does not, at first sight, seem to be borne out by the raw data from the LSE for the number of companies quoted, at least until recent years. In absolute terms, there were 2,257 listed companies and funds back in 1999[1] and this figure had risen to 2,933 by 2007, before falling back to 1,791 in 2019[2]. In fact, over this 20-year timespan, the aggregate number of companies rose in nine years, but fell in 11.

Looking at the total number of LSE companies doesn't seem to bear out the common view…

No. of companies listed on the LSE

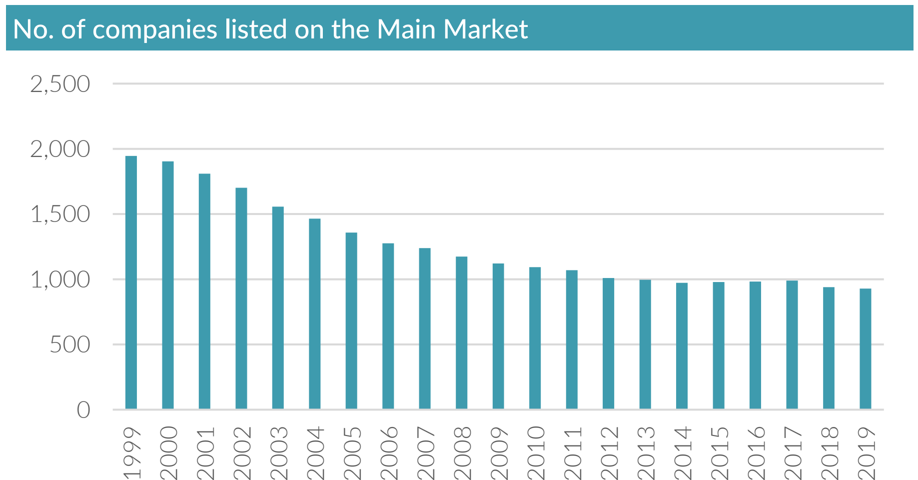


Source: LSE, QCA, Hardman & Co Research

However, looking at the market as a whole masks a far bigger story. The path for the Main Market has been very different to that for AIM over this 20-year period. The Main Market has seen a steady attrition in the number of companies, with a decline in 17 years of the 20-year period, and with only fairly marginal upticks in the three years of growth.

…because the long-term decline in the number of Main Market companies…

No. of companies listed on the Main Market



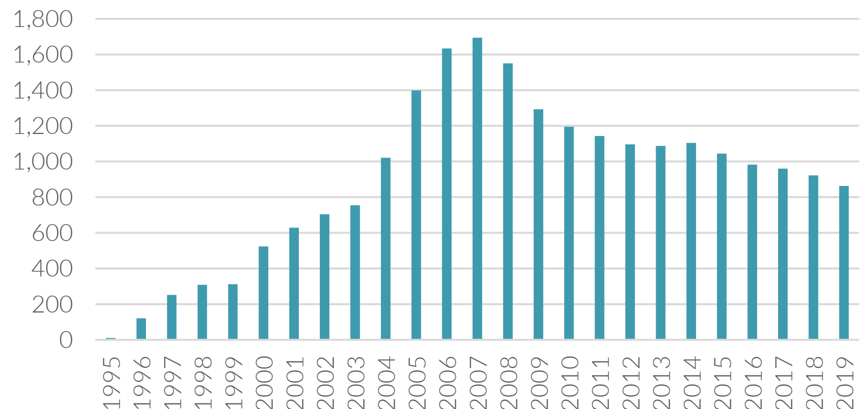
Source: LSE, QCA, Hardman & Co Research

[1] All these datapoints are struck on the last trading day of the calendar year.
[2] The numbers in this paragraph are the totals for the Main Market and AIM added together, but exclude what are described as "International" or "Overseas-Listed" companies.

In contrast, AIM has been a great success story. It has raised large sums for growth companies over many years. In the years leading up to the Global Financial Crisis (GFC), a veritable flood of companies joined AIM; back in 1999 there were 312 quoted, but this had exploded to 1,694 by 2007. Since then, it has seen a faster decline in listings by percentage than the Main Market (AIM listings -49%, Main -25%). The total number of AIM stocks had fallen to only 863 by 2019.

...was offset by the extraordinary success of AIM until the GFC

No. of companies listed on AIM



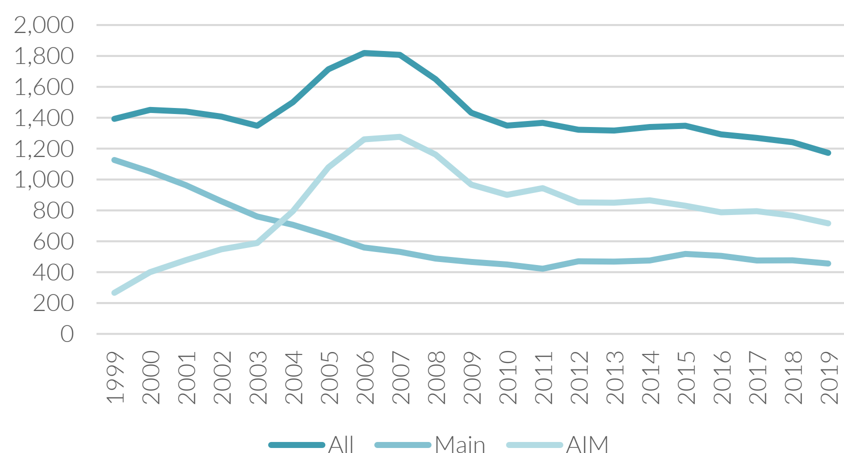
Source: LSE, QCA, Hardman & Co Research

Some readers might argue that the data provided above is all very well, but might be misleading because it includes financials and, in some way, these are not the same as trading companies; financial services form a large part of the UK economy and stock market. The chart below shows the results without any financials. See the methodology for the full list of sectors excluded.

Stripping out all financials produces a steeper decline in the number of Main Market companies

The overall pattern might seem very similar to the previous charts, with the success of AIM more than offsetting the decline on the Main Market in the mid-2000s, but the story is far starker for the Main Market. The total number of companies quoted on that market fell from 1,945 to 928 between 1999 and 2019, a decline of 52%. However, when we strip out the financials, we are left with a decline from 1,126 to 456, a fall of 60%.

No. of companies listed, ex-financials



Source: LSE, QCA, Hardman & Co Research

The number of SmallCap "trading companies" on the Main Market has fallen 72% in the last 20 years

The next table examines the data for SmallCaps. To construct it we have taken the entire universe of LSE quoted companies, excluded the 350 largest companies by MCap on the whole market and then excluded the financials (see Methodologies, definitions and clarifications for the sectors excluded) to leave us with "trading companies" outside the 350 largest of all companies[3].

Numbers of non-financial companies outside the top 350

	All	Main	AIM
1999	1167	886	281
2019	959	252	707
% change	-18%	-72%	152%

Source: LSE, QCA, Hardman & Co Research

What we find is that the number of these "trading companies" on the Main Market has fallen by 72% over our survey period. As explained before, this was offset, somewhat, by the success of AIM.

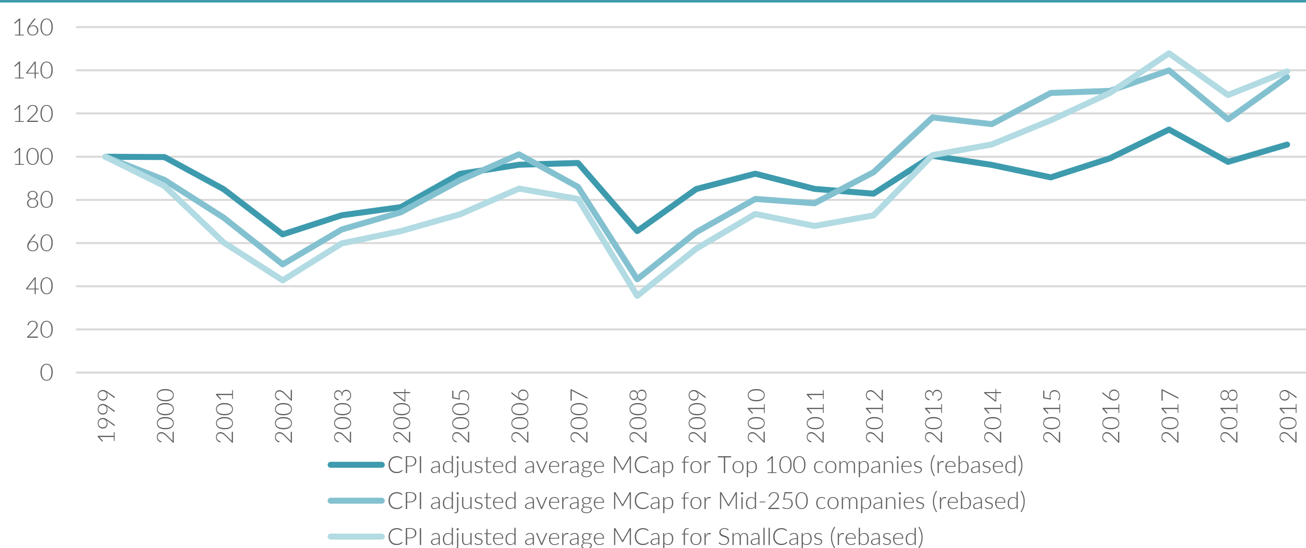
The average MCap of a quoted company

Looking at the number of quoted companies, and IPOs, is one method of judging the shrinkage of public markets. Another is to consider the average MCap of quoted companies and new companies joining the market.

We adjust MCap for inflation

In the chart below, we have split the quoted universe into three baskets: the 100 largest companies by MCap (the 'Top 100 companies'); the next 250 largest ('Mid-250 companies'); and, finally, the 'rest' (described as SmallCaps in the chart below). The rest combines everything, including AIM, outside the top 350. Considering absolute MCap over a 20-year period, without taking account of inflation, is clearly misleading; the data below is adjusted for Consumer Price Inflation (CPI), with each line starting from a base of 100 in 1999.

CPI-adjusted average MCap by size universe



Source: LSE, Office for National Statistics, QCA, Hardman & Co Research

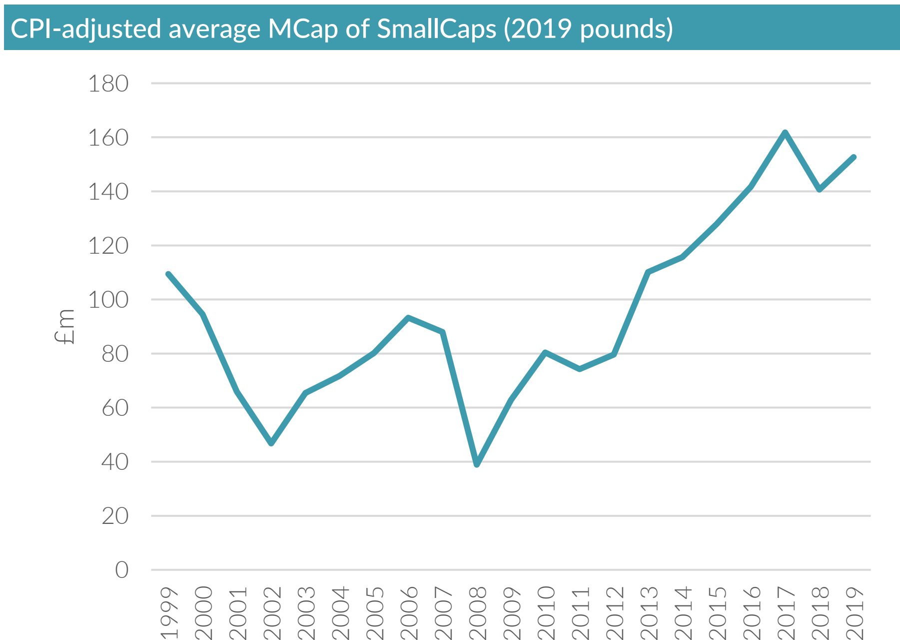
[3] We excluded the 350 largest companies in each year for the Main Market and AIM combined, even though we then look at "trading companies" on the Main Market only. For the purist, there were four AIM-listed companies which formed part of our top 350 cohort in 1999, one of which was a financial. In 2019 there were 19 AIM stocks in our 350, two of which were financials.

The path of MCap is broadly similar, whichever size basket you consider. Of course, there will always be a top 100 and 350 (so long as there are at least 350 quoted companies in London!), so the fact that the average MCap for both baskets has risen substantially over time really tells us nothing about the public markets' effectiveness. It is the line for SmallCaps that is telling. Even when adjusted for inflation, there has been a substantial increase in the average MCap of a small quoted company. In fact, of the three baskets, the SmallCaps has seen the largest rise. Small listed companies have got bigger!

In the chart below, we look specifically at SmallCaps. The average non-350 company's MCap stood at £152.7m at the end of 2019. Back in 2008, it was only £38.9m, even when inflated by CPI. Since this chart combines Main Market and AIM stocks, it's more than coincidental that the low point in 2008 occurs at nearly the same time that listings peaked on AIM.

Even when we adjust for inflation, the average SmallCap has got substantially larger in MCap

CPI-adjusted average MCap of SmallCaps (2019 pounds)



Source: LSE, Office for National Statistics, QCA, Hardman & Co Research

Initial Public Offerings by number

The number of IPOs since the GFC has been subdued

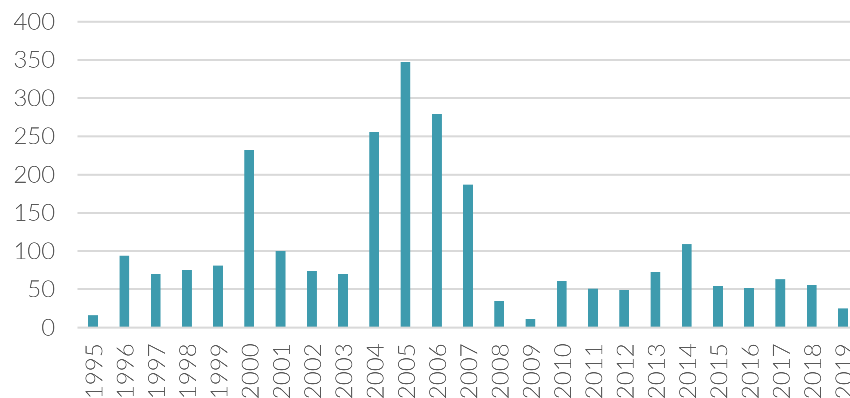
The number of companies on the LSE has been squeezed from both directions – more companies have delisted, whilst London has seen fewer IPOs in recent years.

We calculate that there were 3,137 IPOs between 1995 and 2019. For the purposes of this paper, we want to focus on "trading companies". Thus, we have excluded "Investment Companies"[4] from the charts in this section; there were 614 IPOs of investment companies in the period, leaving 2,523 trading companies in the basket.

Apart from the boom years around the GFC, we have seen a subdued level of new listings for some while.

[4] See Methodology/Clarifications for detail of companies excluded

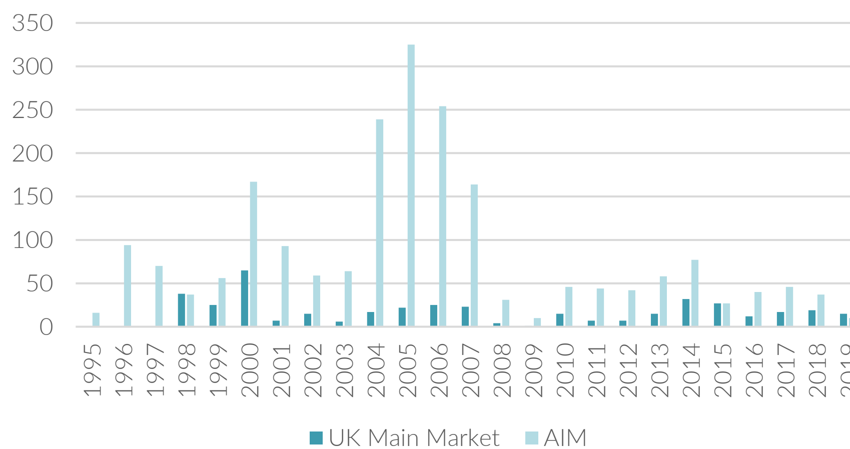
No. of new IPOs on LSE (ex-Investment Companies)



Source: LSE, QCA, Hardman & Co Research

The significance of the boom years on AIM is very clear if we separate Main Market from AIM, as set out below.

No. of IPOs (ex-Investment Companies) on LSE Main Market & AIM



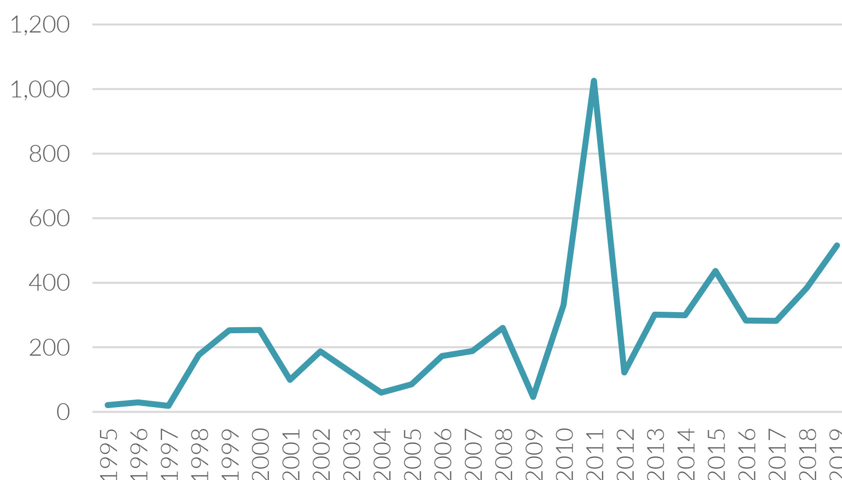
Source: LSE, QCA, Hardman & Co Research

Initial Public Offerings by MCap

The same message about increasing MCap emerges when we consider IPOs. The chart below uses the MCap at the end of the first trading day for each IPO, excluding Investment Companies.

The average MCap at IPO has been rising for some time now, even when adjusted for inflation. Glencore's IPO in 2011 distorts the chart

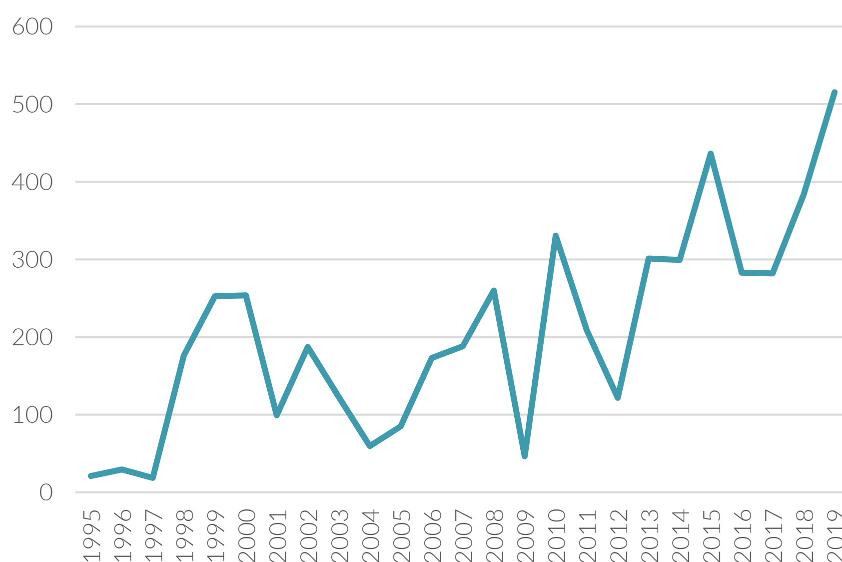
CPI-adjusted average MCap at IPO (ex-Investment Companies) in £m; base year = 2019



Source: LSE, QCA, Hardman & Co Research

The reader will notice a pronounced high in 2011. That year, Glencore listed with an initial MCap of US$60bn! Below, is the chart without Glencore. Last year, the average MCap at float was £515.4m, up from £21m in 1995 (inflated to 2019 pounds).

CPI-adjusted average MCap at IPO (ex-Investment Companies) in £m, excluding Glencore in 2011 base year = 2019

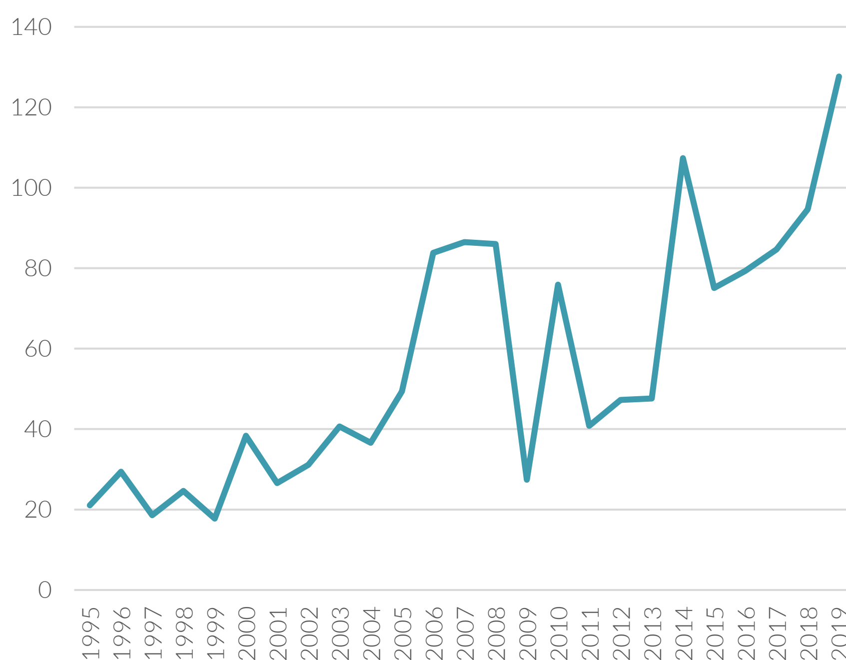


Source: LSE, QCA, Hardman & Co Research

To get more of a feel for the smaller end of the market, we have extracted the data for AIM. Last year, the average first day MCap on AIM was £127.7m compared with £21m back in 1995, both expressed in 2019 pounds.

There has been a dramatic increase in the average MCap at IPO on AIM. Investors seem to be setting size thresholds, below which it is increasingly difficult to get issues away

CPI-adjusted average MCap at IPO of AIM companies (ex-Investment Companies) in £m; base year = 2019



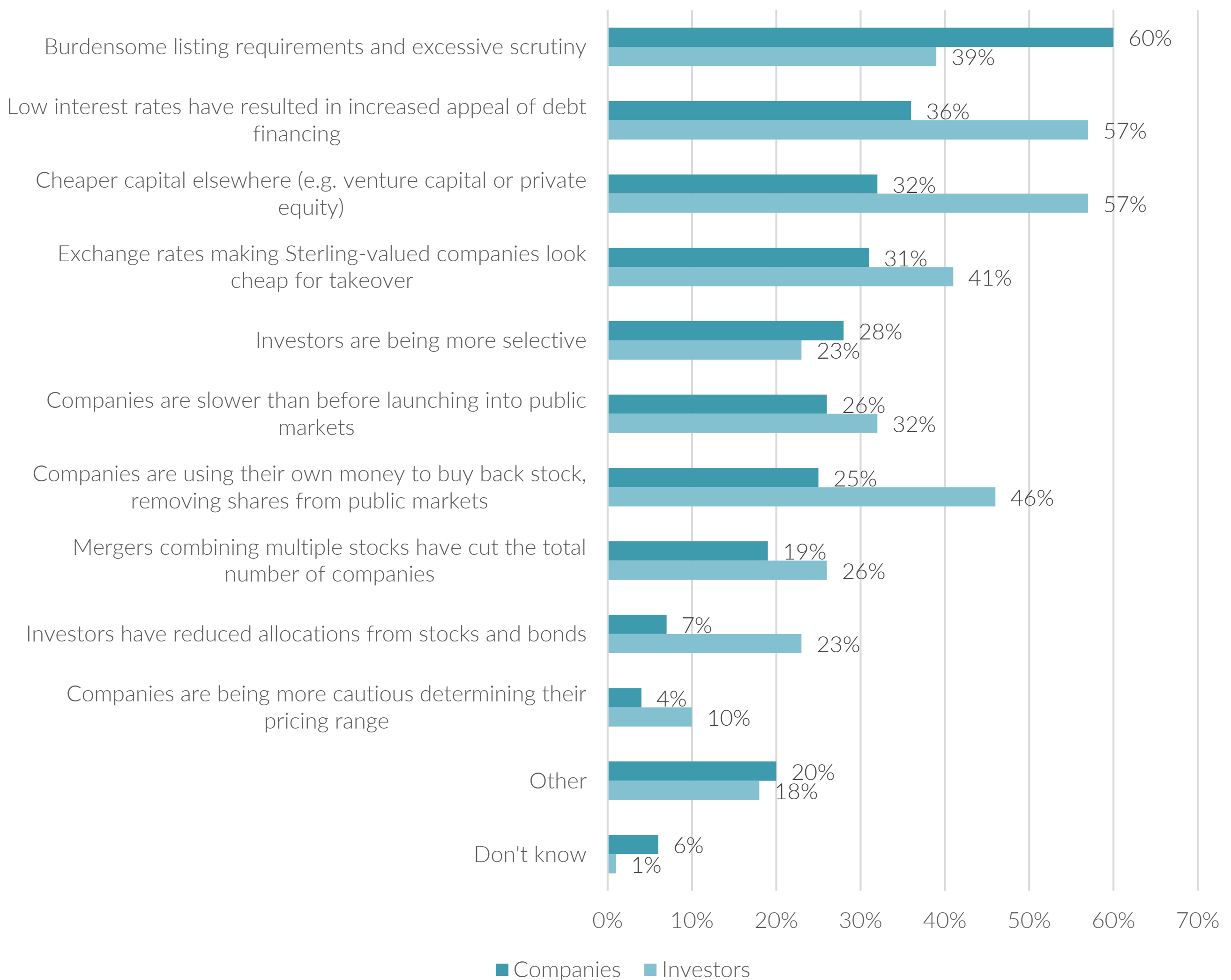
Source: LSE, QCA, Hardman & Co Research

Explaining the shrinking equity market

Some very helpful data from recent QCA surveys with Peel Hunt and YouGov

The data and charts we have laid out above seem to demonstrate there has indeed been a de-equitisation of public markets, represented by shrinkage in the number of companies on the LSE, fewer IPOs and higher MCaps, albeit masked by the success of AIM until 2007. We now turn to the explanation of this trend. As we pointed out when considering the size of IPOs, the challenge is getting small and mid-cap companies to join the market. The QCA is an industry body representing participants in the middle and lower reaches of the public market in London. Usefully, in the past 12 months, it has published two reports surveying the opinions of both companies and investors in the small and mid-cap universe.

What are the main drivers of the shrinking UK public markets?



Source: QCA, Peel Hunt, YouGov[5]

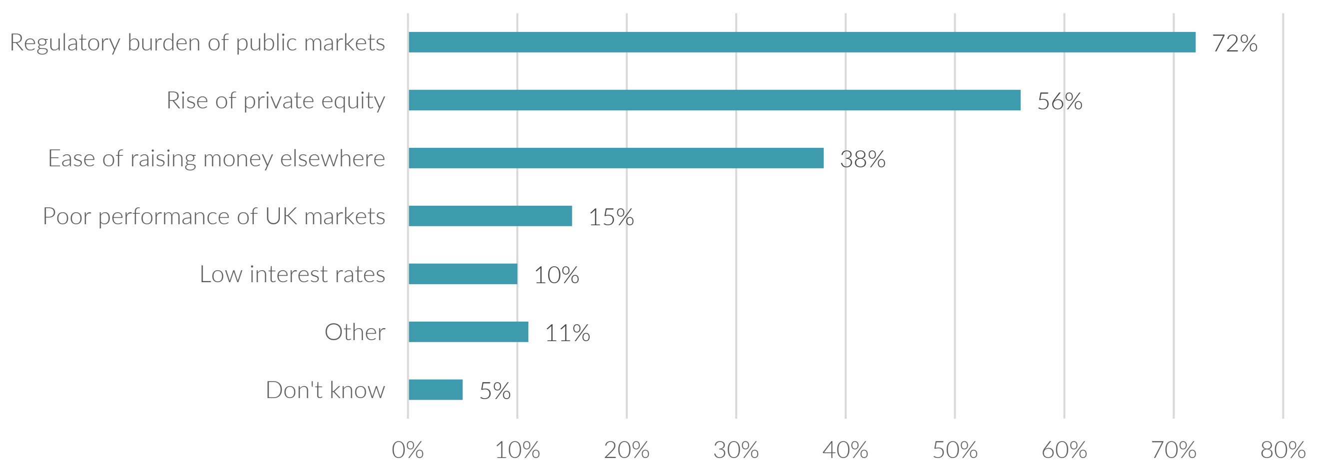
[5] QCA/Peel Hunt Mid and Small Cap Survey, February 2020, conducted by YouGov: *To be or not to be... a public company - The growing de-equitisation crisis*, Page 7

Both QCA surveys suggest the regulatory burden is the biggest hurdle in companies' thinking about de-equitisation

This year's QCA/Peel Hunt Mid and Small Cap Survey focused on the issue of de-equitisation. Fund managers, and mid and small-cap UK quoted companies, were asked what they thought the main drivers were. Companies worried about listing requirements and excessive scrutiny (60% response), whilst the highest scoring questions among fund managers were low interest rates (57%) and cheaper capital elsewhere (57%).

A different poll carried out in June 2019 for the QCA by YouGov (the QCA Small & Mid-cap Sentiment Index)[6], reached very similar conclusions about the fall in the number of quoted companies in London – 72% of managements referred to the regulatory burden.

The number of companies on public equity markets in the UK has fallen in the recent decades. Why do you think this is?

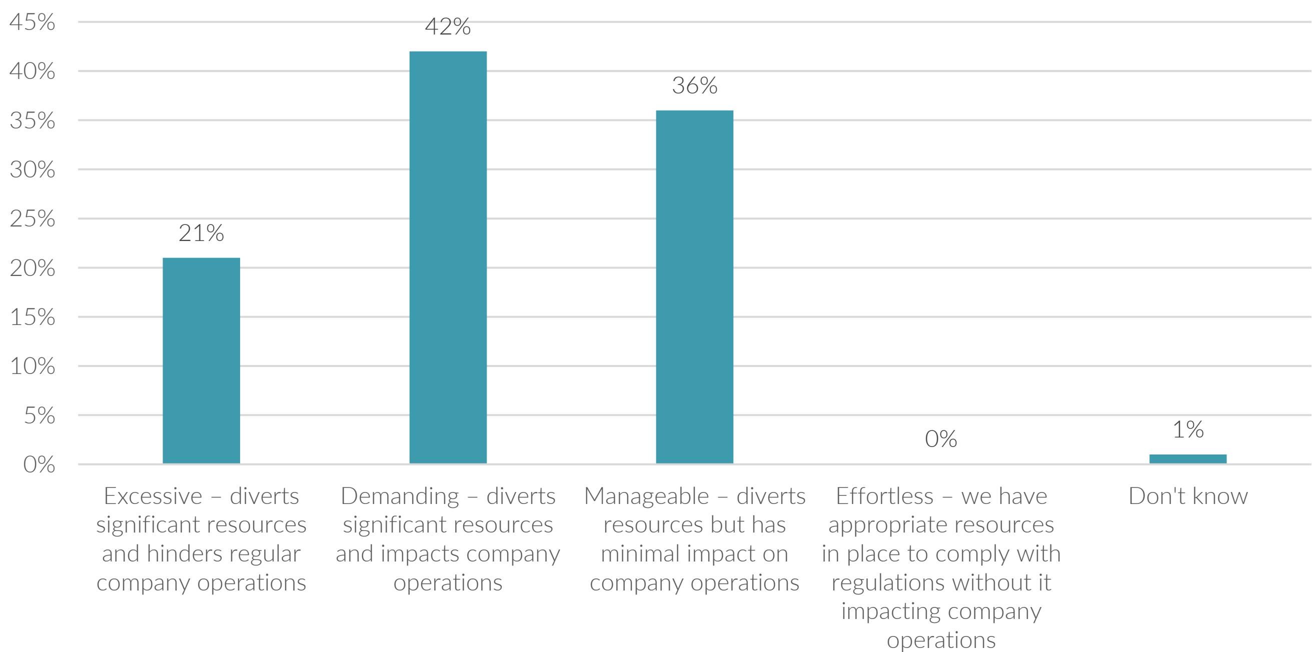


Source: QCA, YouGov[7]

A further question in the QCA Small & Mid-cap Sentiment Index delved deeper into the issue of compliance. It asked the managements of small and mid-cap UK quoted companies: *"Thinking about the resources (e.g. time, money, manpower etc) that your company has to commit to complying with regulation as a whole, which of the following best describes the impact this has?"* Nearly two-thirds (63%) found regulatory compliance either excessive or demanding, only one-third find it manageable.

[6] QCA Small & Mid-cap Sentiment Index: *Regulatory burden & small & mid-sized quoted companies in the UK* by YouGov, June 2019, Page 3
[7] QCA Small & Mid-cap Sentiment Index: *Regulatory burden & small & mid-sized quoted companies in the UK* by YouGov, June 2019, Page 6

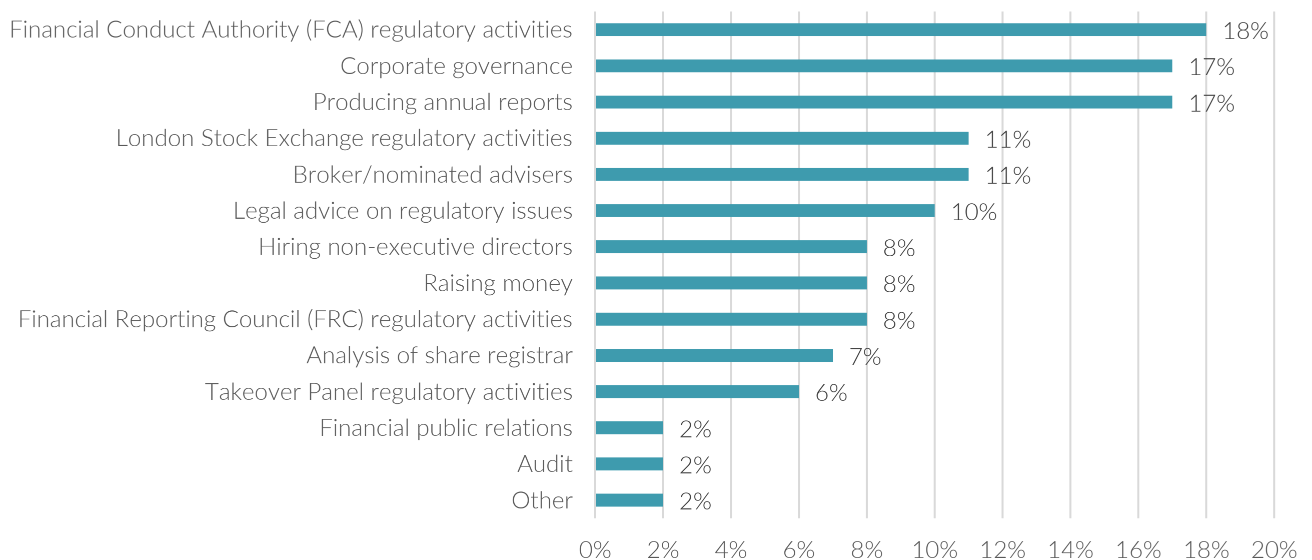
Quoted companies' views on the impact regulation has on them



Source: QCA, YouGov[8]

Which regulatory requirements most deter companies from the public markets? The QCA Small & Mid-cap Sentiment Index finds that the three most burdensome listing requirements are FCA rules, corporate governance, and providing annual reports.

Companies: which of the following listing requirements, if any, does your business find most difficult to adhere to?



Source: QCA, YouGov[9]

[8] QCA Small & Mid-cap Sentiment Index: *Regulatory burden & small & mid-sized quoted companies in the UK* by YouGov, June 2019, Page 3

[9] QCA Small & Mid-cap Sentiment Index: *Regulatory burden & small & mid-sized quoted companies in the UK* by YouGov, June 2019, Page 4

Professional investors seem increasingly less interested in small and mid-cap companies for many reasons

We believe there are additional reasons explaining the decline in the number of quoted companies beyond those identified in the two QCA surveys:

- Most professional investors have increased the minimum MCap they require before considering a company and the consolidation of many fund managers into global groups has certainly meant they have tilted towards global companies.
- Professional investors are paying more attention to liquidity. Thus, the poor liquidity which many smaller companies suffer means they fail a benchmark test set by a fund manager. For some, the liquidity test is simply an MCap filter, for others, a hurdle of minimum percentage traded is employed.
- Another restriction applied by many compliance departments to professional investors is a limit on the maximum percentage of a company's equity which may be owned. This has become increasingly common since the events at the Woodford Equity Income Fund, where some holdings were so large as a percentage of the equity that they were, in all practical senses, unsaleable. Such limits will have a dramatic impact on SmallCaps, because, historically, a cadre of fund managers specialising in SmallCaps took stakes which might now be considered too risky.
- Increased regulation for, and consolidation of, wealth managers discourages fund managers in these organisations from moving beyond a centrally generated list of stocks focused on collectives and the FTSE100.
- Risk aversion has become more important than hunting returns. For example, wealth managers are required to categorise every individual by attitude to risk, choosing just one category. They cannot say the individual wants 90% of their money invested for medium risk, with 10% in very high risk. It's all or nothing.
- Allocations of funds by large professional investors to private equity (PE) investors have grown, enabling PE houses to compete more aggressively for opportunities against the public market. Some have questioned whether PE houses are willing to help companies in temporary distress by putting in more equity; those commentators argue that these houses are all too willing to add further debt.
- As the first three points outlined above have come to bear, small cap company managements have found it increasingly difficult to raise money, not just at IPO, but in subsequent fundraisings. Many question why they should bother continuing to be a public company.

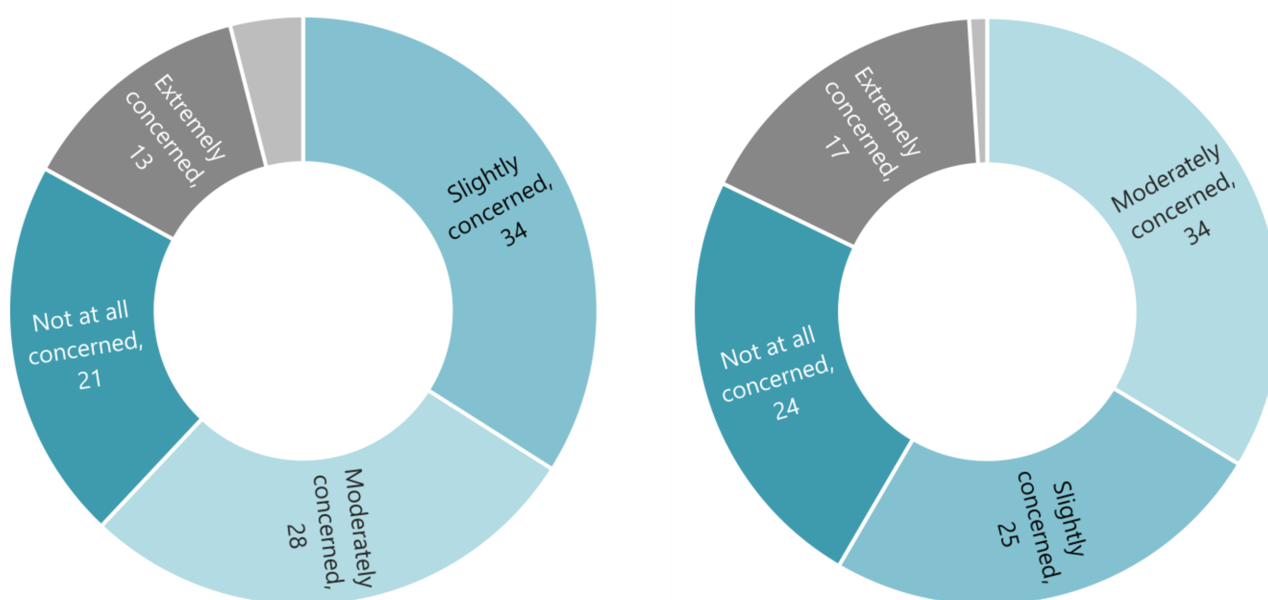
Increasing regulation has created "homogenisation". SmallCaps are ignored

- Increasing regulation on professional investors has led to a "homogenisation" of investment, i.e. everybody tending to own the same stocks. Inevitably, this has reduced interest in SmallCaps.

Does it matter?

The evidence from the QCA work is that there is a great degree of concern. When asked *"How concerned or unconcerned are you about the de-equitisation of the UK's stock markets due to factors such as share buybacks, acquisitions and reduced numbers of IPOs?"*, 75% of mid and small-cap quoted companies expressed concern about the de-equitisation trend, as did 75% of investors.

Quoted company management concern about de-equitisation, %	Investor concern about de-equitisation, %



Source: QCA, Peel Hunt, YouGov[10]

One fund manager commented:

> *"I am extremely concerned that being listed is no longer seen as something to aspire to. This rather obviously reduces the available investment opportunities but has wider negative implications:*
>
> *(i) reduces the ability of companies to efficiently raise capital (ii) reduces the ability of investors to access companies to invest in (iii) reduces price discovery (iv) reduces the ability to regulate companies (v) reduces efficient capital allocation and therefore value creation.*
>
> *I could go on – stock markets are good things and de-equitisation is very worrying."*[11]

[10] QCA/Peel Hunt Mid and Small Cap Survey, February 2020, conducted by YouGov: *To be or not to be… a public company - The growing de-equitisation crisis*, Page 5
[11] QCA/Peel Hunt Mid and Small Cap Survey, February 2020, conducted by YouGov: *To be or not to be… a public company - The growing de-equitisation crisis*, Page 5

The current coronavirus crisis provides a perfect illustration of the benefits of being public. Despite the volatility of markets, quoted companies have raised substantial sums in new equity in recent weeks

The current coronavirus crisis provides a perfect example of the benefits of being a quoted company. Although the capital markets go through periods of fashion, whatever the mood of the moment, companies that can easily raise fresh equity capital tend to be the more robust. This may matter less in booming economic conditions, when companies with little debt might be described as having inefficient balance sheets! However, managements often find that relying on high debt and ignoring the public markets eventually comes back to bite them.

A public listing provides quoted companies with more financing options

Exaggerating to make a point, having access to the public markets might be likened to being able to draw money from an ATM. If the public markets work well, they provide very fast access to new funds. Of course, being public, and having such access to new equity, also tends to reduce borrowing costs. Above all, being listed gives a company options it would not otherwise have.

More borrowing usually means management must focus on the short term, whereas permanent equity capital allows a long-term view to be taken

Despite the recent dislocation to markets, many companies have still been able to raise new equity relatively quickly to get them through this extraordinary period. This has meant they will not be saddled with (what might be) an onerous burden of interest payments on borrowing. Greater borrowing tends to shift management attention to managing for the short term, ensuring there is enough cash flow to meet the covenants that the lender imposes. Meeting financing needs through the permanent capital of equity allows the long-term view to be taken.

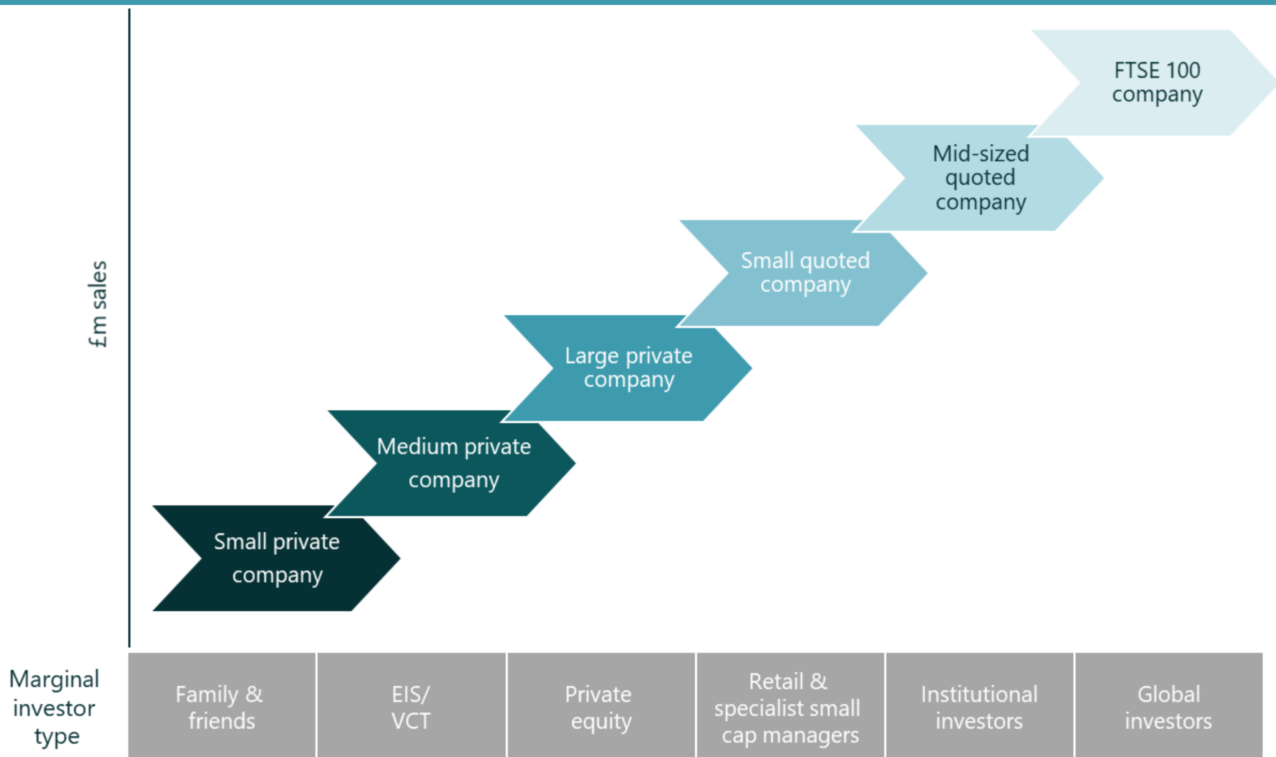
Even in the volatile month of March quoted companies were able to raise more than £600m in fresh equity capital

In the month of March alone, £640m in new equity was raised on the LSE by trading companies (i.e. excluding issues by Investment Companies), including £216m for SSP and £171m for Aston Martin. Indeed, the total will, in reality, be much larger than this since many fundraisings were announced in the month, which are in the process of completing or have completed in April. Of course, we are not suggesting that all these issues were distress-driven, but the fact that the market can still fulfil its purpose of raising new capital, even in these extreme circumstances, amply demonstrates its utility. It also makes a good case for listing in London!

A healthy public market should attract new, smaller companies, expanding the choice for investors, whilst broadening the range of finance sources available to managements.

The schematic below shows, in a very simplified form, how new investors come in at different stages in the lifecycle of a company. For example, many large, global investors are unlikely to be attracted to a company until it joins the FTSE100 index. At the other extreme, small private companies often can only raise money from friends and family. Of course, this is simplified because, in reality, there is an overlap between investment interest at several stages.

How new investors come in at different stages in the lifecycle of a company



Source: Hardman & Co Research

Becoming a quoted company has other benefits:

- Acquisitions: quoted companies have a currency – shares with a readily available share price, to use for acquisitions.
- Reputation: in general, quoted companies have the higher public presence and this is normally accompanied by greater trust, both of which can generate sales, make it easier to find employees, etc.

Graduating from being a private to a public company has many benefits. Delaying crossing that watershed is harmful to both companies and the economy.

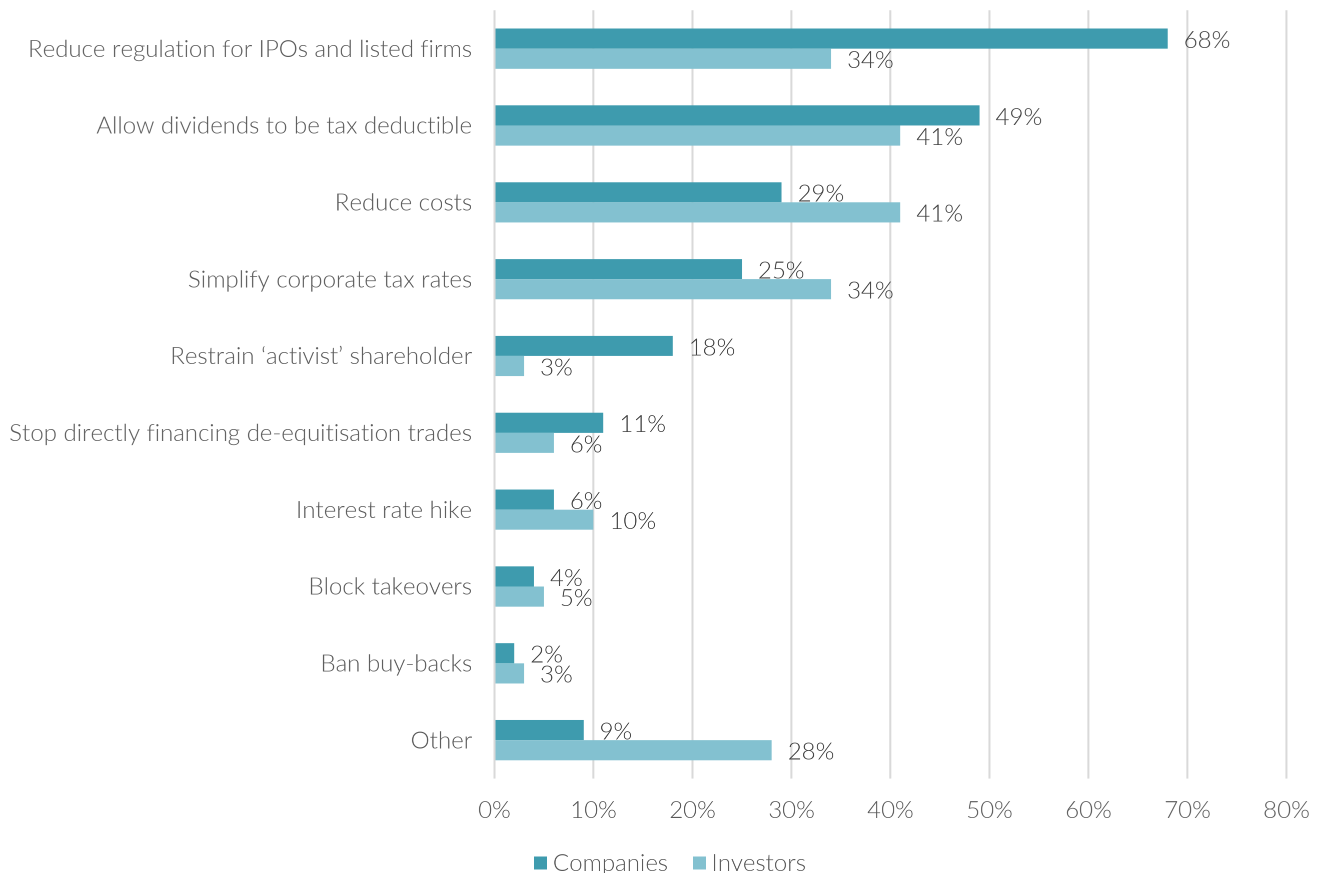
Tim Ward, CEO of the QCA, eloquently summarised why de-equitisation matters in the recent QCA/Peel Hunt Mid and Small Cap Survey[12]:

"The decline in smaller companies coming to the public markets has wide implications for the country, including reducing the options of financing for companies, in driving too large a proportion of companies to be reliant on bank financing, and reducing opportunities for people's pensions to be invested for growth in the future."

[12] QCA/Peel Hunt Mid and Small Cap Survey, February 2020 *To be or not to be… a public company: The growing de-equitisation crisis*, Page 2

What can be done to encourage companies to IPO or stay public?

How can the UK Government increase the flow of private companies to list on to the UK stock market?



Source: QCA, YouGov[13]

Regulation of companies

The latest QCA/Peel Hunt Mid and Small Cap Survey makes it abundantly clear what company management think needs to be done – 68% call for reduced regulation, with 49% calling for dividends to be tax-deductible.

Should small companies be subject to the same regulatory rules as the goliaths of the FTSE 100?

Tim Ward, CEO of the QCA, has suggested "*the need for proportionality in policy and regulation for smaller quoted companies. There is a huge disparity in size on the UK's public equity markets with the largest company in the FTSE 100 having a market capitalisation of over £188 billion, and the smallest company in the FTSE All-Share having a market cap of £42 million - that is just 0.02% of the size. Both companies are required to follow the same rules - this does not make sense at all.*"[14]

[13] QCA/Peel Hunt Mid and Small Cap Survey, February 2020, conducted by YouGov: *To be or not to be… a public company - The growing de-equitisation crisis*, Page 20
[14] QCA/Peel Hunt Mid and Small Cap Survey, February 2020 *To be or not to be… a public company: The growing de-equitisation crisis*, Page 2

One commentator implored in the QCA Small & Mid-cap Sentiment Index report "*Make it simpler -more regulation does not equal less corporate failure, just makes companies less efficient. Reduce the rubbish in annual reports and make them more readable -most are novel length now but sadly are slightly more interesting than reading the small print on a finance document*."[15]

The AIM market is part of the solution on regulation, but the authorities should ease the prospectus rule…

The AIM market was established to create a lighter touch listing venue than the Main Market. The Government should actively engage with such markets to unlock the road jams. In particular, consideration should be given to easing the rules around prospectuses, making it easier, cheaper and faster to raise money for smaller companies. These rules require a full prospectus, with massive legal cost, to be produced for the issue of new, listed equity, with certain exemptions[16]. The effect is to discourage companies from going down that route and encourage them to ignore retail investors. Is it any wonder that since 1995 only 30 prospectuses have been issued by AIM companies?

…and reconsider MAR

The new regulations on insider dealing (Market Abuse Regulations) are another case in point. They genuinely frighten some managements, who fear being convicted for poor record-keeping, not insider dealing!

Re-weighting pension fund assets

Should pension funds be encouraged into growth companies?

Many market participants think the Government should encourage a pension "re-weighting" back to equities away from bonds, as the US has done. In the QCA/Peel Hunt Mid and Small Cap Survey, 55% of companies and 62% of investors agreed with this proposition.[17] Practical suggestions include:

- the requirement to hold a certain percentage of the portfolio (say 3%) in SME growth stocks;
- tax benefits on dividends, with penalties on bond interest;
- ending the disincentive for existing personal pensions, that are over the lifetime allowances, to take risk; and
- allowing trustees to take a longer-term perspective.

Solving the problem of large investment managers

The concentration of fund management decisions has not helped SmallCaps

- We have seen an acceleration of "conglomerisation" in the fund management industry. The market is in the hands of fewer and fewer managers. Often this means they have little interest outside the FTSE100. Perhaps the Government should require the Competition and Markets Authority to consider whether a merger is in the interests of the stock market next time a merger is proposed.
- Large investment managers treat their holdings across funds as one for many purposes. If they could ringfence the holding in each fund that would effectively increase the fragmentation of the stock market, which would help SmallCaps find more investors. Several rules would need to be changed.

[15] QCA Small & Mid-cap Sentiment Index: *Regulatory burden & small & mid-sized quoted companies in the UK* by YouGov, June 2019, Page 8

[16] A prospectus is not required if the offer is restricted to "qualified investors", the total value is less than €8m, or not directed to more than 150 non-qualified persons; there are other exemptions. https://www.handbook.fca.org.uk/handbook/PR.pdf Page 9

[17] QCA/Peel Hunt Mid and Small Cap Survey, February 2020, conducted by YouGov: *To be or not to be… a public company - The growing de-equitisation crisis*, Pages 23 and 24

The Government becomes an investor in SmallCaps

The Government should become an investor for the long term, so long as civil servants don't try to become fund managers

- The Government has already announced a Future Fund to support the UK's innovative businesses currently affected by Covid-19, in cooperation with the British Business Bank.
- The Government should consider further long-term investment strategies to support quoted SmallCaps. However, we are not suggesting civil servants try to become fund managers. Rather, a series of SmallCap specialist fund managers should be awarded mandates to manage money on behalf of the Government. Perhaps, there should be mandates by regions and/or sectors.

Improve liquidity

An improvement in liquidity would encourage investors to look at smaller companies

- Make it easier for individual fund managers (particularly wealth managers) to deviate from a centralised list without being "punished".
- Encourage investors in SmallCaps by extending tax breaks such as widening EIS and IHT reliefs.
- Make the facility for retail investors to take part in IPOs, etc. mandatory. A good example has been the LSE support of PrimaryBid's involvement in secondary issues (although not mandatory).

Steps should be taken to speed up the open offer process, making it more attractive to companies

- Encourage companies to involve retail investors by speeding up the fund-raising process. At the moment, companies undertaking an open offer have to send documents by post and get replies by post, a process taking two weeks. Yet the same investors can request dividends to be paid electronically and receive the Annual Report digitally. Surely, the time has come to speed up the open offer process, reducing the period of risk for companies and advisors. This would make open offers more popular among companies and advisors. Any measure that widens the investor audience helps liquidity.

Self-help by companies

Companies can help themselves by improving their engagement with all investors

We have written many times before about steps companies can take to improve interest in their shares. These include:

- increase research coverage – MiFID II has made it uneconomic for brokers to cover most small and mid-cap stocks, so consider a sponsored research house (an unapologetic plug for Hardman & Co);
- hold capital markets days;
- broadcast results meetings more widely; and
- improve the corporate website.

Conclusion

We find that public markets in London have shrunk in recent years, from whichever angle you view them.

Shrinking markets are bad for companies, the economy and society

We believe that shrinking public markets matter. They are bad for companies, the economy and society. Efficient public markets bring many benefits to companies, such as access to larger and more varied pools of capital, from which we all gain. The success of public companies in raising fresh equity in recent weeks to plug holes caused by the coronavirus lockdown is powerful testament to the utility of public markets.

There are positive steps that can be taken to reverse the trend of de-equitisation

Choking off access to public markets has not been a conscious choice of anyone, but rather an unintended consequence of other actions and trends. All stakeholders, including the UK Government, should consider the steps needed to meet this challenge. We believe that regulation on companies should be rolled back (particularly easing the prospectus rules), pension funds encouraged to re-weight towards growth companies and steps taken to improve liquidity. Companies themselves could help by engaging more with investors through a number of routes. Other steps, highlighted in this paper, could also make a difference.

A greater fragmentation of investment decisions which creates more active decision makers in the SmallCaps, involving retail investors, rather than ignoring them, would improve liquidity. This would go some way towards resolving many problems and help end an environment which increasingly ignores quoted SmallCaps.

Methodologies, definitions and clarifications

Methodology for Hardman & Co-generated charts

- **Data sources:** We have used publicly available data from the LSE and Office for National Statistics (CPI data only).
- **Dates/years:** When data for a particular year is used, the datapoint is the number (e.g. market capitalisation or number of companies) at the close of the last business day of that year.
- **Inflation:** We have used the Consumer Prices Index (CPI) as the measure of inflation, rather than the Retail Prices Index. The difference is simply housing costs, which are excluded from the CPI, but included in RPI. We think CPI is more relevant to investors.
- **Investment Companies:** Where data is stated to exclude "Investment Companies", it excludes all companies which have been classified by the LSE as belonging to one of the following sector categories:
  - Closed End Investments
  - Equity Investment Instruments
  - Investment Companies
  - Investment Companies Other
  - Investment Entities
  - Investment Trusts
  - Nonequity Investment Instruments
  - Open Ended and Miscellaneous Investment Vehicles
  - Real Estate Investment Trusts
  - Split Capital Investment Trusts
  - Venture Capital Investment Trusts

  We have used data back to 1995 in some results, and 1999 in others. Sector definitions and names have, inevitably, changed over that time period. Thus, the same quoted entity may have been formed part of one or more of these sector descriptions over time. Often these titles just represent the renaming of the same sector. For example, closed-ended funds used to be described as "Investment Trusts", but are now called "Investment Companies".

- **IPOs:** We have used the raw data published by the LSE. The data used is the MCap at the close of the first day's dealings. We have adjusted this data by excluding:
  - Investment Companies (see above for nomenclature);
  - IPOs which are reported as having either a MCap of £0m or where no MCap was recorded; and
  - international companies, where the London listing is a secondary one.

- **Number of companies listed, ex-financials:** Our chart is based on data from the LSE, excluding:
  - companies where the dataset returns a zero MCap; and
  - financial stocks, defined as being belonging to one of the sectors specified below in the table *No. of companies listed, ex-financials.*
- **'Mid-250 companies':** When this term is used, it refers to the next largest 250 companies by MCap, after the "Top 100 companies" for each year. Its constituents are not necessarily the same as those of the FTSE 250.
- **'SmallCaps':** This refers to any qualifying listed company which is not included in either the Top 100 companies or the Mid-250 companies.
- **'Top 100 companies':** When this term is used, it refers to the largest 100 companies by MCap for each year. Its constituents are not necessarily the same as those of the FTSE 100.
- **Weightings:** Where an average figure is shown it is a simple average, unweighted for market capitalisation.

QCA/Peel Hunt Mid and Small Cap Survey methodology[18]

- **Investor survey:**
  - YouGov carried out an online survey of 155 UK-based fund managers between September and November 2019.
  - The list of fund managers was created from names supplied by Peel Hunt, the QCA and YouGov.
- **Corporate survey:**
  - There were 110 interviews with mid and small-cap UK quoted companies, which took place between October and November 2019.
  - An online interview of members and associates of the QCA was used to create the survey.

QCA Small & Mid-cap Sentiment Index methodology[19]

- YouGov interviewed 117 parties between April 2019 and June 2019.
- There were 78 interviews with small and mid-cap UK quoted companies, and 39 with advisory companies.
- YouGov used an online system to interview members and associates of the QCA.

[18] QCA/Peel Hunt Mid and Small Cap Survey, February 2020 *To be or not to be… a public company: The growing de-equitisation crisis*, Page 42

[19] QCA Small & Mid-cap Sentiment Index: *Regulatory burden & small & mid-sized quoted companies in the UK* by YouGov, June 2019, Page 11

No. of companies listed, ex-financials –excluded sectors

Year	Sector 1	Sector 2	Sector 3	Sector 4	Sector 5	Sector 6	Sector 7	Sector 8	Sector 9	Sector 10
1999	Banks	Insurance	Investment Companies	Investment Companies Other	Life Insurance	Speciality & Other Finance	Real Estate			
2000	Banks	Insurance	Investment Companies	Investment Companies Other	Life Insurance	Speciality & Other Finance	Real Estate			
2001	Banks	Insurance	Investment Companies	Investment Companies Other	Life Insurance	Speciality & Other Finance	Real Estate			
2002	Banks	Insurance	Investment Companies	Investment Companies Other	Life Insurance	Speciality & Other Finance	Real Estate			
2003	Banks	Insurance	Investment Companies	Investment Entities	Life Insurance	Speciality & Other Finance	Real Estate			
2004	Banks	Insurance	Investment Companies	Investment Entities	Life Insurance	Speciality & Other Finance	Real Estate			
2005	Banks	Insurance	Investment Companies	Investment Entities	Life Insurance	Speciality & Other Finance	Real Estate			
2006	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate			
2007	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate			
2008	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate			
2009	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate			
2010	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate	Real Estate Investment & Services	Real Estate Investment Trusts	
2011	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate	Real Estate Investment & Services	Real Estate Investment Trusts	
2012	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate	Real Estate Investment & Services	Real Estate Investment Trusts	
2013	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate	Real Estate Investment & Services	Real Estate Investment Trusts	
2014	Banks	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate	Real Estate Investment & Services	Real Estate Investment Trusts	
2015	Banks	British Funds	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate	Real Estate Investment & Services	Real Estate Investment Trusts
2016	Banks	British Funds	Equity Investment Instruments	General Financial	Life Insurance	Nonequity Investment Instruments	Non-Life Insurance	Real Estate	Real Estate Investment & Services	Real Estate Investment Trusts
2017	Banks	Financial Services	Insurance				Real Estate			
2018	Banks	Financial Services	Insurance				Real Estate			
2019	Banks	Financial Services	Insurance				Real Estate			

Source: LSE, Hardman & Co Research

About the authors

Keith Hiscock is the Chief Executive of Hardman & Co.

He is personally responsible for the firm's relationships with its corporate clients and also for corporate finance. In addition, he is the author of several articles tackling the issues facing companies in today's climate.

Keith has more than 35 years' stockbroking experience and has developed long-standing relationships with many major institutional investors, including Private Client Brokers and Wealth Managers. He started his career at James Capel, at the time the top-ranked research house in London. He was a founding member of Schroder Securities and of Agency Partners, a leading research boutique house, and was a member of the five-man securities board at Evolution. Keith has also advised companies, large and small, on their relationships with the capital markets.

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Tim Ward, CEO of Quoted Companies Alliance

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