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Dear Sirs,

Building our Industrial Strategy

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

We welcome the opportunity to respond to the Government's Green Paper: Building our Industrial Strategy and applaud the prime minister's vision to create "the conditions where successful businesses can emerge and grow".

There is no question that the departure of the UK from the European Union is going to bring changes to the economy and the structure of the financial markets in the UK. Without underestimating the inevitable challenges of the forthcoming separation the QCA sees this as an opportunity to shape the existing market structure so that in the long-term it works more effectively and efficiently for everyone.

We want to encourage more companies to look for long-term, patient capital through growth markets, such as AIM and NEX Exchange, and challenge the current model of "one share, one vote" which we consider to be a barrier to young, growing companies led by innovative founders choosing to list on public markets.

You will find below more detailed responses to specific consultation questions.

Q19 What are the most important factors which constrain quoted companies and fund managers from making longer term investment decisions, and how can we best address these factors?

Longer-term investment decisions are constrained by several issues: the short-term time horizons of investors and their clients; by a fiscal structure that encourages short-term thinking and inhibits the raising of long-term capital; and by not fostering a long-term view by investors through good corporate governance practice. These are described in more detail below.

Short-term time horizons

Quoted companies are often subject to pressure to achieve growth forecasts and to deliver immediate returns for investors. This focus on short-termism constrains the ability of quoted companies to make strategic long-term investments that could yield much greater returns on investment in five to ten years' time.

Company directors spend a significant amount of time worrying about fluctuations in the company's share price which may reflect badly on the company's reputation instead of focussing on making long-term investment decisions. This is a situation that does not affect private firms but is very familiar to quoted companies.

Tax – debt v equity

The OECD has illustrated how equity has distinct benefits over debt: "The empirical results reported above suggest that in most OECD countries more debt is typically associated with slower growth while more stock market financing generates a positive growth effect. Furthermore, recent OECD work[1] (Ahrend and Goujard, 2012) found that corporate tax systems which favour debt over equity are associated with a higher share of debt in external financing, thereby increasing financial crisis risks. The economic literature and earlier OECD work identified that the debt bias in corporate taxation generates costly economic distortions (De Mooij, 2012; Devereux et al., 2013; OECD, 2007). These findings all underline the growth benefits of reducing the debt bias in corporate taxation. Effective average tax rates on equity finance generally exceed those on debt finance, primarily because interest expenses are cost-deductible."[2]

Creating a tax system fit for growth companies

An ever-changing taxation system can also constrain a quoted company's ability to plan long-term. We have become increasingly concerned that some areas of tax legislation impose a disproportionate compliance burden on small and mid-size quoted companies. More simplification and certainty of the tax system would greatly help develop the growth potential of quoted companies.

In our Proposals for Taxation Reform[3] for the 2017 Budget, we have set out proposals to assist the Government in creating a simple and reliable tax system which would reduce the compliance burdens on small and mid-size quoted companies.

Encouraging long-term investment

We believe that the EIS and VCT rules should be refined and simplified to ensure that small and mid-size quoted companies are able to fully leverage venture capital schemes and thus raise the finance they need to grow and create employment.

Consideration should be given to adjusting the rules so that venture capital schemes, such as EIS and VCT, are targeted at all growing companies, regardless of their age. We have seen examples of growth

[1] http://www.oecd-ilibrary.org/economics/drivers-of-systemic-banking-crises_5kg3k8ksgglw-en?crawler=true
[2] Cournède, B., O. Denk and P. Hoeller (2015), "Finance and Inclusive Growth", *OECD Economic Policy Papers*, No. 14, OECD Publishing, Paris.
[3] Quoted Companies Alliance Proposals for Taxation Reform – 2017 Budget: http://www.theqca.com/article_assets/articledir_253/126681/QCA%202017%20Budget%20Representations_Working%20Document%20-%20FINAL_Jan17.pdf

companies that have sought and received investment, but are ineligible to take advantage of EIS and VCT, due to the time limits imposed.

Some of the conditions in the EIS/VCT rules may also be very difficult for small and mid-size quoted companies, particularly those regarding new products or geographical markets and skilled employees.

Moreover, we believe that the new rules have placed an additional burden on many advance assurance applications which has led to increased waiting time for responses. This in turn has placed further constraints on companies seeking to raise financing for their businesses.

As a solution, we propose that the resources at the Small Companies Enterprise Centre should be increased to ensure that the complexity is reduced and timescales are brought down so that the service allows the venture capital schemes to achieve the objective of supporting small, growing companies.

Long-term structures through good corporate governance

Corporate governance arrangements play a significant role in a fund manager's decision to invest in a company. Whereas the UK Corporate Governance Code is too onerous for smaller companies to comply with it remains important for companies of all sizes to have good corporate governance arrangements in place to attract investors.

The QCA Corporate Governance Code for Small and Mid-Size Quoted Companies has been in place for over twenty years and is specifically designed to enable quoted companies at different stages of development and of different sizes to adopt good corporate governance practice. It has been developed by the community for the community and is a practical and beneficial way of getting companies to actively think about and implement good governance. Over time, it has helped hundreds of companies to understand the importance of corporate governance and the longer-term value it creates for the company and consequently its investors.

Q22 What are the barriers faced by those businesses that have the potential to scale-up and achieve greater growth, and how can we address these barriers? Where are the outstanding examples of business networks for fast growing firms which we could learn from or spread?

The existing structure of the equity market and its regulation needs to be re-considered. Existing assumptions about how markets operate should be explored and tested. The labour market should be kept open.

Equity market structure and regulation

Access to affordable finance coupled with expensive and burdensome regulatory and administrative requirements are the main barriers for companies seeking to scale up. New rules are often aimed at larger companies and smaller businesses tend to be overlooked in the process. What is a reasonable expectation for a large company is often a disproportionate requirement for smaller companies. We would therefore encourage the Government to start thinking **small first** in its policy proposals.

Furthermore, we propose that the Financial Conduct Authority is required to take the specific interests of smaller quoted companies into account. Currently, cost benefit analysis is conducted on the stock market as a whole, which leads to the regulatory concerns surrounding large listed companies to have an anti-growth effect on smaller quoted companies.

To reinforce the "**small first policy**" we recommend that the FCA's objective should be dual: it should oversee the good operation of financial markets and deliver ongoing growth and productivity improvement in the UK. This would put the FCA in a position where it would have to weigh the cost of additional regulation against any potential adverse economic effect that might result. This new objective could underline the importance of addressing the underdeveloped portion of institutional capital allocated to growth companies, especially smaller quoted companies.

Testing current assumptions

We suggest that all aspects of a public listing be looked at, not just improving education about the existing market arrangements. We encourage the Government to explore alternative vehicles for public company investment. One such example would be considering how to overcome the reticence of entrepreneurs to "give up control too early" when they join a public market. New IPO companies, who adopt a suitable corporate governance code and with suitable stakeholder representation, could be allowed to list variable voting shares on the stock market. This would allow entrepreneurs to maintain control of the company they have founded and manage succession over a longer period of time.

We understand that some 40% of all companies on the Swedish stock market, including the growth market First North, have some form of variable voting right structure. There were 88 IPOs on the Swedish markets in 2016 compared to 114 on the London Stock Exchange's markets.

Furthermore, recent success stories of Google and Facebook demonstrate that differentiated voting rights do not hold back investors from investing in companies that have variable voting rights. Instead of asking why there isn't a Google in the UK we should be challenging investor preconceptions about such issues as variable voting rights. Why do they invest in Google with variable voting rights but refuse to do the same for a similar style UK company? Does this discourage UK growth companies? Are there other factors to consider also?

Access to labour

In view of the UK's departure from the European Union, another barrier might become access to skilled labour. The creation of intellectual property depends on people as a key resource and if the free movement of people from the European Union is severely curtailed as a consequence of the separation it will make it extremely difficult for UK companies to hire the highly skilled individuals from EU Member States that they need in order to stay competitive. This would create an additional barrier putting UK growth companies at a clear competitive disadvantage and go against the Government's efforts to boost growth and productivity.

Successful networks

Regarding successful business networks, Silicon Valley continues to be considered an outstanding example of an environment that fosters a mutually beneficial business network for fast growing firms. In the UK, Cambridge has developed an effective network of fast growing technology companies.

Conclusion

In this time of uncertainty the Government needs to take decisive and innovative action to ensure future growth and better productivity. We call on the Government to commit to breaking down barriers to long-term finance. Cutting red tape, creating a proportionate regulatory framework and simplifying the tax system will all contribute to establishing a growth-friendly environment. But we believe that more can be done. We ask the Government to initiate action to explore alternative investment vehicles and challenge investor preconceptions. Only by truly pushing the existing boundaries will we be able to establish a more fertile ground for growth companies to scale up and become the Google's of tomorrow.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive