

Report of the Quoted Companies Alliance Conference

Engineering Growth for Small and Mid-Cap Companies

27 June 2012

Highlights

163 delegates attended including:

- small and mid-size quoted company directors
- advisors to the sector
- investors, brokers and market makers
- journalists

3 MPs/MEPs spoke and participated in the event

6 fund managers attended and spoke about raising finance

5 panel sessions held on:

- the future of equity finance
- the role of reporting in helping companies to grow
- corporate governance and shareholder engagement
- fund managers debating how to incentivise investment into small and mid-size companies
- broadening companies' funding options

2 keynote speakers were:

- David Gauke MP, Exchequer Secretary to the Treasury
- Dr Kay Swinburne MEP for Wales in Europe

21 business leaders, policymakers, investors, regulators and more spoke at the event

Synopsis of the day's sessions

Keynote Speech - David Gauke MP, Exchequer Secretary to the Treasury

Tax breaks, loan guarantees and a reduction in red tape will help small and medium-sized companies to grow and create a sustainable economic recovery, the Exchequer Secretary to the Treasury told the Quoted Companies Alliance conference.



In the keynote speech David Gauke MP said that small and medium-sized (SMEs) enterprises were the “engines of growth” in the UK economy and were responsible for about half of the UK’s private-sector output.

Gauke said that the Government wanted to work in partnership with SMEs. He outlined Government measures to boost investment in small and mid-size companies and make it easier for the companies to do business and grow.

Measures include:

- Government-backed lending schemes, including the £190bn ‘Project Merlin’ loan guarantee scheme for UK businesses
- More generous tax relief for Venture Capital Trusts that invest in SMEs
- Corporation tax to be cut to 22% by 2014
- Plans to make tax system simpler and the introduction of ‘real time Pay As You Earn’ tax deductions
- A plan to introduce “cash-based” accounting in an effort to make it easier and quicker for SMEs to get their tax right

In a question and answer session after Gauke’s speech, a delegate stated that most Government finance schemes aimed at helping fast-growing companies were about debt rather than equity. More should be done to help SMEs raise finance through equity, the delegate said.

Gauke said that lending and equity were equally important. “It’s not necessarily either or [debt or equity finance],” Gauke said. “It’s a case of supporting all forms of equity and borrowing. We are trying to pull every lever to make it easier for firms to get finance in one form or another.”

“

We are trying to pull every lever to make it easier for firms to get finance in one form or another. ”

- David Gauke MP

Panel 1: The future of equity finance

- **Chairman:** Nadhim Zahawi MP
- Laurence Marsh, Analyst, Winterflood Securities Limited
- Peter Ashworth, Smaller Companies Analyst, Charles Stanley Securities
- Chris Hardie, Corporate Finance Director, Arden Partners plc

Small businesses are getting plenty of help from the Government in accessing bank loans but more needs to be done to help UK technology start-ups, delegates at our conference heard.

And despite the economic turmoil in the euro zone and an uncertain economic outlook for the UK economy, there were glimmers of hope for small and mid-size companies.

In a session on the future of equity finance, panellists said that companies with good potential can still get funding from equity markets.

Peter Ashworth, Smaller Companies Analyst at Charles Stanley Securities, said that many equity investors were “more sanguine” than lenders about the growth prospects of small companies and could be more understanding about blips in their growth.

Chris Hardie, Corporate Finance Director at Arden Partners, said: “Small companies coming to market at the

moment perhaps have to be a much better company than five years ago.”

New tax incentives for Venture Capital Trusts will encourage investment in small companies and help build bridges between public and private sectors. “We are seeing new biotechs coming to market and raising small amounts of money,” Hardie said.

New forms of funding – such as “peer-to-peer” lending (online platforms, which enable individuals to provide loans directly to each other as well as to small businesses) and multinationals investing in their supply chains – are providing a welcome fillip to small and mid-sized companies, panellists also said.

Nadhim Zahawi, a Conservative MP, said that some big companies in the car industry were starting investing in supply chains. Such investment could boost growth among small and mid-sized suppliers and make them less reliant on equity and debt finance, he said.



Panel participants (left to right):

Laurence Marsh

Analyst, Winterflood Securities Limited

Peter Ashworth

Smaller Companies Analyst, Charles Stanley Securities

Chris Hardie

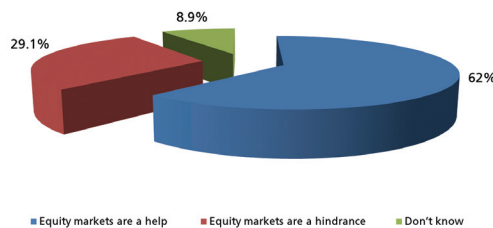
Corporate Finance Director, Arden Partners plc

Nadhim Zahawi MP

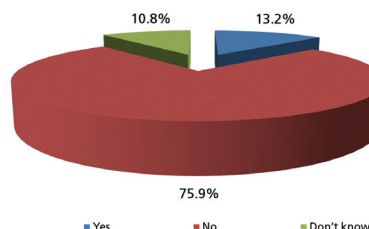
Chairman of the panel

Interactive questions following the panel

Are the equity markets currently a help or a hindrance to the development of small and mid-caps?



Is the Government doing enough to support small and mid-cap growth?



Panel 2: Just a lot of numbers and words? The role of reporting in helping companies to grow

- **Presentation:** Matthew Stallabrass, Partner, Crowe Clark Whitehill LLP
- **Chairman:** Alan Newman, Chief Financial Officer, YouGov plc
- Patricia McConnell, Board Member, International Accounting Standards Board
- Andy Brough, Fund Manager, Schroder Investment Management

Size matters with annual reports, the conference heard.

Over the past decade company annual reports have become longer and more complicated. The increase in size is due to increased financial reporting regulations, audit firms 'disclosure checklists' and company boards failing to prioritise information.



However, short annual reports can contain more useful information for investors than bulky ones, according to Matthew Stallabrass, Partner at accountancy firm Crowe Clark Whitehill.

"There is a danger that material information [in company annual reports] will be clouded in immaterial clutter," Stallabrass told delegates at the Quoted Companies Alliance conference.

Information in annual reports will vary according to companies' size and their industry, Stallabrass said, but all reports should do five things:

- Explain company strategy and risk
- Give a balanced review of the business – the good and the bad
- Focus on "material matters" that can affect share price and financial performance
- Give a fair and true picture of financial performance
- Provide consistent information

A move towards global accounting rules – International Financial Reporting Standards (IFRS) – is supposed to make life easier for investors and companies, but some panellists were sceptical.

Alan Newman, Chief Financial Officer at YouGov, a market research agency, said it was time "to ditch this ridiculous experiment to have one set of accounting standards across the world."

There is a slimmed down version of IFRS for SMEs, which is used by millions of businesses worldwide, but can not be used by quoted companies.

International accounting standards may be unpopular with some small and mid-size quoted companies, but they are essential, said Patricia McConnell, Board Member at the International Accounting Standards Board. Accounting standards help investors by making it easier to compare financial information, McConnell said.

IFRS has become a "passport" to raise capital in local markets and across borders, McConnell said, adding that IFRS will pay off in the end because it helps businesses grow.



Panel participants (left to right):

Matthew Stallabrass,
Partner, Crowe Clark Whitehill LLP

Patricia McConnell
Board Member, International Accounting Standards Board

Andy Brough
Fund Manager, Schroder Investment Management

Alan Newman
Chief Financial Officer, YouGov plc



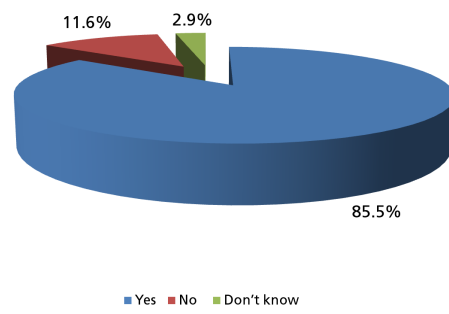
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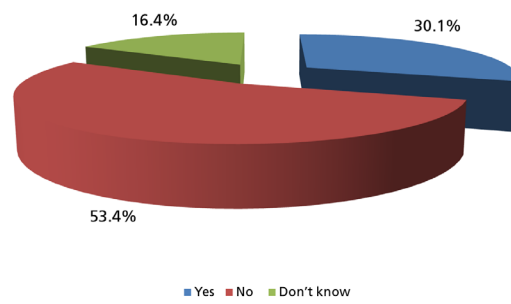
- Matthew Stallabrass, Partner, Crowe Clark Whitehill LLP

Interactive questions following the panel

Should small and mid-caps have their own set of proportionate reporting requirements?



Has IFRS been a force for better reporting?



Panel 3: The corporate governance balancing act: Shareholder engagement in the current environment

- **Chairman:** Tim Goodman, Associate Director, Hermes Equity Ownership Services
- James Thorne, Fund Manager, Threadneedle Investments
- Stephen Hadrill, Chief Executive, Financial Reporting Council
- Sarah Wilson, Chief Executive Officer, Manifest

The head of the UK's accountancy and corporate governance watchdog has said that he is encouraged by the recent increase in shareholders challenging companies.



In the past few months, shareholders at companies including WPP, the advertising conglomerate, and Aviva, an insurer, have voted against their companies' remuneration proposals, in what has been dubbed the "shareholder spring".

Stephen Hadrill, Chief Executive of the Financial Reporting Council (FRC), said: "Shareholders have been quite targeted in votes against company boards. This has been driven by concerns about value creation and concerns about whether shareholders are getting a fair slice of the pot."

Good corporate governance can help to build trust between companies and investors, Hadrill said. Some small quoted companies have complained that the financial reporting rules can be onerous. Hadrill said that he had a "lot of sympathy" for arguments that financial reporting and corporate governance standards should be

proportionate, partly based on the size of the company. Asked whether the FRC could use its "comply or explain" principle (whereby companies have to explain in their annual reports why they haven't followed the corporate governance code) for financial reporting rules for small and mid-size quoted companies, Hadrill said that he was not sure comply or explain was the right approach. Another option would be to simplify accounting standards for small and mid-sized companies, he said.

Sarah Wilson, Chief Executive Officer of Manifest, a proxy voting and corporate governance support service, said that the quality of financial reporting among small and mid-caps is often "much better and more personal" than the biggest companies in the FTSE 100.

Wilson said that executive pay – which includes the thorny issue of giving shares to non-executive directors – is a "window into the corporate soul." "Get this right and you will get other things right," she said.

Getting it right will be made easier if a company has a good relationship with its shareholders. Investors told the conference that they were willing to listen to small and mid-cap companies.

James Thorne, Fund Manager at Threadneedle Investments, said that majority of fund managers were ready to engage with companies and explain their reasons for any votes against boardroom remuneration reports or other matters.

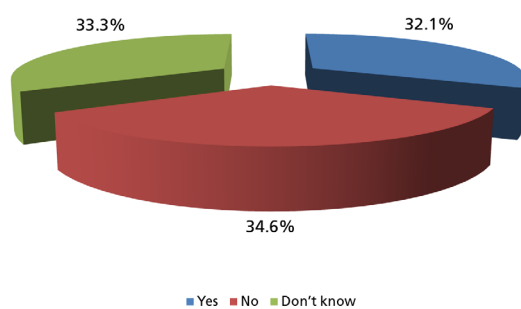
Tim Goodman, Associate Director at Hermes Equity Ownership Services, said that corporate governance was not just about remuneration. "[Corporate governance] should also be about long-term strategy and risk management," he said.

“ Corporate governance should be about long-term strategy and risk management. ”

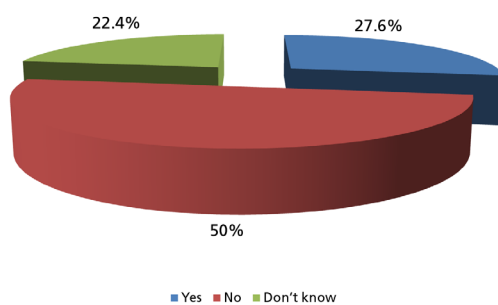
- Tim Goodman, Associate Director, Hermes Equity Ownership Services

Interactive questions following the panel

Are recent regulatory changes in corporate governance positively affecting small and mid-caps?



Is engagement between investors and small and mid-caps improving?



Panel 4: The fund manager debate: Incentivising investment in small and mid-cap companies

- **Chairman:** Tim Ward, Chief Executive, The Quoted Companies Alliance
- Adam McConkey, Fund Manager, Henderson Global Investors
- Judith Mackenzie, Fund Manager, Downing LLP
- Andrew Buchanan, Fund Manager, Octopus Investments

Investors at our conference had bad and good news for small and mid-cap companies.

The bad news was that investment in small and mid-cap stocks in the UK has fallen steadily for the past decade, says Adam McConkey, Fund Manager at Henderson Global Investors, as investors have turned to emerging markets to get better returns on their money.

There is a scarcity of capital and too many choices for investors, while advising companies on listing on AIM is now not profitable enough for investment banks, McConkey added.

But it's not all bad news. Fund managers also said that the UK small and mid-cap markets had good potential. Returns from the small and mid-cap sector have been volatile in the past few years, but returns from the market over the past 10 years are "up there with global

and emerging markets," said Judith Mackenzie, Fund Manager at Downing LLP. "All of us have to clear up what has become a bit of a bad name in investing in small caps," she said.

Changing tax rules on equity could boost the small and mid-cap market, said another panellist. "We need to change the tax treatment of equity which is taxed several times over, whereas debt receives a subsidy from the taxpayer," said Andrew Buchanan, Fund Manager at Octopus Investments. "Equity is moving up the agenda [and is] at the heart of Government. I suspect that their understanding of small business is on the rise."

Encouraging entrepreneurs to grow their companies for decades rather than a few years could also strengthen the small and mid-cap sector, Buchanan said.

Panel participants (left to right):

Tim Ward
Chief Executive, The Quoted Companies Alliance

Adam McConkey
Fund Manager, Henderson Global Investors

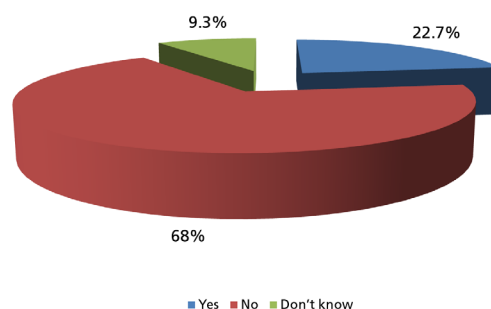
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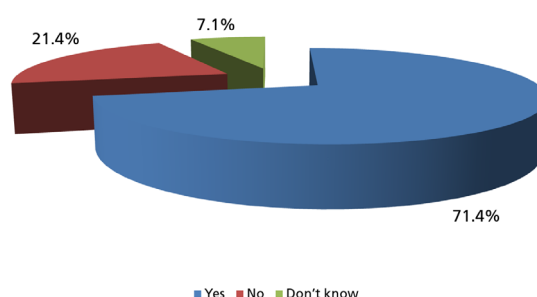


Interactive questions following the panel

Do boards and investors understand each other's priorities well enough?



Can the risk levels of investing in small and mid-caps in general ever be reduced enough to attract more investors?



Panel 5: Mind the gap: How can companies broaden their funding options?

- **Chairman:** Michael Higgins, Chairman, Ebiquity plc
- John Kent, Deputy Chief Executive, City of London Group plc
- Ross Taylor, Corporate Relationship Director, Barclays plc
- Marcus Stuttard, Head of AIM, London Stock Exchange

Invoice discounting, “peer-to-peer” lending and institutional investors could help to close part of the “finance gap” faced by small and medium-sized enterprises (SMEs), finance experts said.



The sources of finance were suggested as alternatives to bank lending, which has become harder to obtain after the 2008 financial crisis, during a discussion about how companies can broaden their financial options.

John Kent, Deputy Chief Executive at City of London Group, an investment company, said that invoice discounting, although common in the US, was “hardly used” in the UK – mainly due to a fear that companies using invoice discounting are “financially shaky”.

In the medium-term, panellists said, one alternative to bank lending for SMEs is peer-to-peer lending. This

enables individuals to provide loans directly to each other as well as to small businesses and is becoming more popular in a number of countries including the UK, US and China.

Kent said that “heavyweight” professional investors, particularly life funds, may also be encouraged to provide more finance to small and mid-size quoted companies.

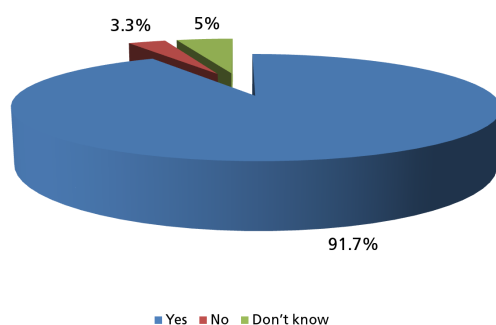
For those small and mid-size quoted companies that do get hold of finance and flourish, the aim should be to aspire to the larger UK stock markets, said Marcus Stuttard, Head of AIM, the London Stock Exchange’s international growth market for small and medium-sized enterprises.

“In the last six weeks I can think of four to five home-grown UK technology businesses that have come to the market and raised [between] £7m and £10m,” he said. “We need [company managers] not to sell out after three to five years but to aspire to be in the FTSE 250.”

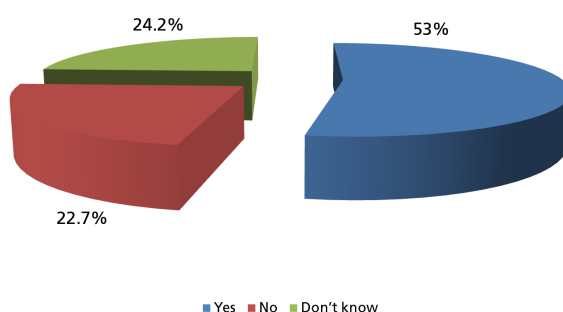
What do banks look for when lending to SMEs? Ross Taylor, Corporate Relationship Director at Barclays, said that the most important thing was proven cash flow.

Interactive questions following the panel

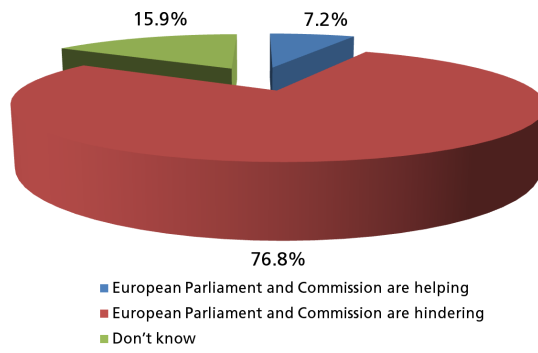
Is there a funding gap for small and mid-caps at the moment?



Will new funding options help deliver the growth Britain needs?



Are the European Parliament and Commission helping or hindering the UK's small and mid-cap companies?



Closing Speech - Dr Kay Swinburne MEP

Plans to create a new category of financial market for small and medium-sized enterprises in the European Union could help small and mid-size quoted companies get finance and grow, the Conservative MEP for Wales in the European Parliament told delegates at our conference.

In the closing speech of the conference Kay Swinburne, who worked in investment banking before politics, said that the proposed SME growth market, which would be introduced through the Markets in Financial Instruments Directive (MiFID), could reduce compliance costs for mid-caps. Proposals on SME growth markets are being finalised, Swinburne said.

New regulations, such as Basel III – which will require banks to set aside more capital to help them withstand financial shocks, and Solvency II, a similar regulation for insurers – may make the system safer, but will also make it harder for SMEs to get bank lending to finance their growth, Swinburne said.

Tax incentives – such as no stamp duty for SME growth

markets and tapered tax relief on capital gains for investors who stick with companies for more than three years – would help SMEs, Swinburne said.



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SMEs account for two-thirds of employment in the EU

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- Dr Kay Swinburne MEP

Comments from delegates about the day

"I rediscovered the quality and importance of the work done by the [Quoted Companies Alliance] - well done."

"Well planned and executed - excellent range of topics presented and debated by an impressive range of speakers."

"Good review of the issues."

"A very interesting and informative day."

"Lots of food for thought and themes to pursue."

"Excellent event with a sensible balance of policy, politics, best practice, challenge and new ideas."

"Good networking."

"[I have] a better understanding of why [the] small and mid-cap market is under performing and illiquid."

"Good update on current thinking."

"Good chance to meet up with some old contacts and make some new ones."

"Good mix of speakers and delegates."

"Valuable networking opportunity."

"Added to my knowledge of additional market-related subjects."

"Got up-to-date on all the issues/challenges threatening growth of smaller companies and what is being done about them."

"[I] understand better the relevance [of the sector] to the economy."

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