Fuelling the engines of growth

The Quoted Companies Alliance Manifesto 2015

21 April 2015

The UK's economy is growing; consumer confidence is stronger; and unemployment is at its lowest since 2008 – time, then, to review preparations for what comes next.

Apart from being susceptible to international economic and geopolitical instability, the UK and wider European economy still feature serious flaws. Addressing these weaknesses and preparing for bumps in the road will create the conditions for stable and sustainable growth.

We believe that the UK Government and EU must continue to ensure that small and mid-size companies (SMEs) are able to raise finance, expand and create jobs. Further economic growth relies on this happening. With bank and debt finance in short supply, Brussels and Whitehall must create an environment in which companies can access public and private equity to raise the finance they need to create wealth.

Of the 23 million SMEs in the EU, only 6,000 are quoted on a Regulated Market or multilateral trading facility (MTF)[1]. Despite the lessons of the financial crisis, most continue to raise finance through debt. There is, for many, a better option. Equity funding has several advantages over debt – there is less constraint on cashflow; capital is retained rather than paying down debt; investors share risk alongside entrepreneurs; there is time to grow business without repayment worries; and equity promotes an investment culture for people to secure their future without relying on the state.

This imbalance must be addressed to promote sustainable business growth and the stakes are high. Of the UK's 5.2 million SMEs[2], some 2,000 of these are quoted – on the London Stock Exchange Main Market, AIM or the ICAP Securities and Derivatives Exchange (ISDX). With a total market value of £351 billion and aggregate £180 billion turnover, small and mid-size quoted companies employ some 1.6 million people – 6.3% of private sector jobs in the UK[3].

These small and mid-size quoted companies, our members, are the engines of growth for the UK economy. They make up the majority of companies accessing public equity financing and represent 80% of all quoted companies in the UK. Yet, because public equity markets are generally seen as a place for huge multinationals, the rules governing these markets are often inappropriate for growth companies.

Here are six ways to ensure the engines of growth can access public equity markets and raise finance to enhance UK growth and create more jobs.

1. Create a minister for equity finance

We have a minister for business and enterprise, a Chancellor of the Exchequer, a Chief Secretary to the Treasury and a Secretary of State for Business, Innovation and Skills. We need a minister for equity finance.

Stock market gyrations can have a huge impact on national economies as well as globally. They also provide a vital source of finance to growing businesses. When bank lending dried up with the financial crisis in 2008, equity markets stepped in to fill the gap in finance, bringing a sharp increase in secondary fundraisings (when a company already on a public market sells more shares to raise money).

[1] ESMA Securities and Markets Stakeholder Group – Report on Helping Small and Medium Sized Companies Access Funding: www.esma.europa.eu/system/files/2012-smsg-59.pdf
[2] Federation of Small Businesses: www.fsb.org.uk/stats
[3] Quoted Companies Alliance research – October 2014

Currently, responsibility for equity finance and related markets is split between the Department for Business, Innovation and Skills and HM Treasury. A single minister to champion equity markets, encourage innovation within them and make sure they are appropriately regulated could help create a pro-business, permanent equity culture in the UK, as in the United States. This could be a minister who already has a portfolio.

2. Enhance tax incentives for equity and entrepreneurs

Government efforts to make banks lend more have failed. Bank finance is temporary and should be used as working capital rather than for the long-term financing of any business. Access to permanent equity capital is the fuel that helps the economy grow and move up a gear. Increasingly, some of the UK's best-performing asset managers who favour growth companies are outspoken on the benefits of long-term investment[4].

More should be done through tax incentives to encourage companies to access equity markets and channel investment into growth companies within a fair tax structure.

Tax relief for the costs of raising equity

Public equity markets are a continuous source of long-term finance for businesses, from the time of their initial public offering (IPO), building support from shareholders to whom they return over the years to raise the capital needed for growth.

Perversely, by making payments on interest tax deductible, the UK tax system encourages companies to raise money through debt finance and penalises them for doing so by issuing shares. Equity fundraising costs should be made tax-deductible to create a level playing field and encourage companies to raise growth capital.

The current situation also puts the UK economy at a competitive disadvantage to other European countries such as France, Germany and Italy, which give some form of corporation tax relief for raising equity finance. Our research shows that 19 other European states have some form of relief for raising equity finance, which highlights the UK's extreme position[5]. Business leaders and finance experts have complained about this illogical tax rule for decades. We have also estimated that this would cost the Exchequer approximately £60m in any given year, a relatively small amount with a big potential payback for the economy. Now is the time for change.

Capital gains tax reform of Entrepreneurs' Relief

We also need tax breaks for entrepreneurs to be a driver of growth. We welcome the UK Government's action in recent years to extend Entrepreneurs' Relief. However, there is a major brake on growth in the details that must be addressed. Currently, owners, partners and employees have to own at least five per cent of a business to qualify for Entrepreneurs' Relief. This requirement is arbitrary and penalises employee shareholders in high-growth businesses. It should be scrapped[6].

Doing so will encourage wider employee share ownership and encourage managers and employees to work more closely to boost inclusive growth.

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[4] See Gervais Williams' most recent book, *The Future is Small: Why AIM will be the world's best market beyond the credit boom*, November 2014.

[5] See the Quoted Companies Alliance Proposals for Taxation Reform: 2015 Budget for more detail on how the tax deduction for the costs of raising equity could work: www.theqca.com/budget2015

[6] See the Quoted Companies Alliance Proposals for Taxation Reform: 2015 Budget for more detail on reforms to Entrepreneurs' Relief: www.theqca.com/budget2015

3. Make small and mid-size quoted companies a distinct economic category

Small and mid-size quoted companies should be treated as a distinct asset class. Small and mid-size quoted companies make up over 80% of all businesses quoted on public equity markets, but there is still no clear and formal definition of these businesses. As a result, they get hit with the same rules as the huge global businesses which policymakers are seeking to regulate.

Policies that apply to large companies sometimes are not necessary or suitable for small and mid-size quoted companies. Rules concerning public markets should not be a one-size-fits-all.

They should be proportionate to the size and complexity of the company. Social policies on issues, such as greenhouse gas emissions and diversity, should be applied to the largest companies, whether public or private, rather than just to quoted companies. The current practice harms small, growing quoted companies even though they're likely to have little or no impact on the situation concerned, impeding their focus on delivering long-term growth.

Clearer definitions will help politicians and regulators make targeted laws and rules for small and mid-size quoted companies and avoid unnecessary red tape – a big hurdle to wealth and job creation.

Companies with an average three-year market capitalisation below £1 billion on both AIM and the Main Market could be included in this new small and mid-size quoted company asset class.

The European Commission is beginning to change some financial market rules to make it easier for small and mid-size companies to access finance from capital markets through the development of special category of public equity market – SME Growth Markets. It is a good start but does not go far enough, nor recognise that small and mid-size companies also access regulated markets (which are not able to become SME Growth Markets under the current rules). The European Commission and our UK politicians should be doing much more.

We want UK and European law that drives job creation and helps, rather than hinders SMEs.

4. Simplify the process of raising public equity

The complex and expensive process of raising public equity in the EU discourages SMEs from accessing this type of finance.

Currently, companies must produce a long and complicated prospectus to raise money from the public. This takes significant management time and money in advisory fees, and the prospectus must approved by the regulator before the funds are raised.

The introduction of the EU's Prospectus Directive in 2005 had the effect of reducing access to public equity for SMEs and there has been a decline in public offers by SMEs since then. Crucially, research shows that investors, especially private investors, are not using the prospectus as the basis for their investment decision, which is the original purpose of the prospectus.[7]

Prospectuses are failing in the original purpose for which they were intended – to provide meaningful information to help make an investment decision – and this must be addressed. A less complex prospectus would mean companies would produce clearer documents that are more relevant to both private and institutional investors. It would also reduce the cost and time required to produce them,

[7] Study on the Impact of the Prospectus Regime on EU Financial Markets - Final Report, June 2008, available at http://ec.europa.eu/finance/securities/docs/prospectus/cses_report_en.pdf

making raising public equity a cost-effective and efficient way for SMEs to raise long-term, sustainable capital[8].

Both the European Commission and UK Government should work to ensure that the 2015 review of the Prospectus Directive facilitates raising public equity, rather than hindering companies' ability to do so. Sustainable and inclusive economic growth relies on companies' ability to access permanent equity capital.

5. Take a time-out on new business regulations

The financial crisis of 2008 and the subsequent global recession sent shockwaves through the economy and society. The crisis triggered a wave of business and financial regulations. Many were necessary; some were not – or were heavy-handed.

Businesses have had to deal with a lot of change in the last three to four years. As the UK economy recovers, we need to focus on growth – not new restrictions on business and financial markets.

We recognise the political urge to tinker, but let's have a pause on new regulations. Meddling with regulations for the sake of it is pointless and damages the economy. Give businesses time to adjust to new regulations. Refine existing rules and encourage businesses to be more open and clearer about how they make their money.

6. Foster a long-term equity culture

Schoolchildren learn about many aspects of life: language, science and relationships; but, not stock markets and finance.

The performance of markets affects everything – the money in our wallets, our pensions, our economy, infrastructure, the number of schools and hospitals, the affordability or creating social good. Children should be educated about how stock markets work, their history and the risks and rewards of capitalism.

This would help children become financially literate and better able to plan for their future. It could also help create a more vibrant and entrepreneurial economy. Recent figures from the Office for National Statistics showed the highest increase in self-employment in recent history.

The business and financial sectors need to be more aligned with private investors and society as a whole.

[8] See the Quoted Companies Alliance's Proposals to amend the Prospectus Directive – February 2015: www.theqca.com/PD2015