Quoted Companies Alliance

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Business, Innovation and Skills (BIS) Committee
7 Millbank
House of Commons
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18 January 2013

Dear Sirs,

BIS Committee – The Kay Review of UK Equity Markets and Long-Term Decision Making Inquiry

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.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

Our Corporate Governance Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Response

We are grateful for the opportunity to submit our views to you on the recommendations emanating from the Kay Review.

Whilst we are generally supportive of the recommendations made by Professor Kay, we continue to have major concerns that the Kay Review has been developed on an assumption that the equity markets no longer have a primary, finance raising function. The report says:

> *2.6 Equity markets have not been an important source of capital for new investment in British business for many years. Large UK companies are self-financing – the cash flow they obtain from operations through profits and depreciation is more than sufficient for their investment needs. This is true of the quoted company sector as a whole and of a large majority of companies within it.*

> *2.7 Finance raised through placings and rights issues by established companies, and initial public offerings (IPOs) by new companies, have generally been more than offset by the acquisition of shares for cash in takeovers and through share buyback (see Figure 4). New equity issuance has therefore been negative over the last decade.*

Equity markets remain an essential source of capital for new investment in British business. Small and mid-size quoted companies are not self-financing and are undertaking activity which is rarely supported by senior finance, whatever the investment environment. Essential finance for the development of new economic growth is raised through share placings and rights issues by established companies and through IPOs by new companies.

Since the launch of AIM in 1995, over £80 billion of capital has been raised through new and further issues. This may have been offset by the acquisition of shares for cash in takeovers and through share buybacks. However, the larger companies, which conduct major programmes for the acquisitions of shares, are mature, ex-growth companies. Such companies are stable cash-generative machines which, understandably, return cash to shareholders. Large multinational companies listed in the UK do not typically create new employment in the UK and the rest of Europe.

Inevitably, the amount of cash returned to shareholders by larger companies is a greater amount than that raised by small and mid-size quoted companies – or 'growth companies'. Each growth company needs essential capital to develop; often this is not a great amount. The cash volumes raised by growth companies are necessary to deliver new employment, economic activity, government revenues and economic returns to investors. Even if this is, in total, a smaller amount than that paid back to shareholders by large companies, each pound invested to deliver new growth is worth a multiple in the wider economy, as has recently been highlighted in Lord Heseltine's report *No Stone Unturned in Pursuit of Growth*.

We urge the Select Committee to focus on the role of equity markets as a key source of capital for growth companies. Private equity and corporate debt have a role to play but companies need a range of options and equity markets need to be one of these, not least as an exit route for early investors. The most recent QCA/BDO Small and Mid-Cap Sentiment Index[1], published in November 2012, reported that in terms of funding sources public equity and listed debt issuance were both growing in attractiveness at the expense of bank finance and private equity. 50% of respondents chose public equity as their preferred source of finance if the need arose in the next 12 months[2].

We agree with Professor Kay's analysis that at the present time the primary equity markets are not functioning effectively. We believe that it is time for a fundamental review of the primary equity markets to ensure they are fit for purpose to support the raising of capital and the liquidity that goes hand in hand with investment both in 2013 and for the years to come. The continued concentration of mind by regulators, policymakers and lawmakers, at both UK and European levels, on share trading in the largest companies in the secondary market means that the primary equity markets are being starved of essential support in the delivery of investment and capital.

Quoted Companies Alliance Corporate Governance Guidelines for Smaller Quoted Companies

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[1] http://bdoqcasentimentindex.co.uk/

[2] The survey figures are based on a quarterly online survey across the small and mid-cap quoted sector, with members and associates of the Quoted Companies Alliance (QCA) and contacts of BDO. The responding sample is weighted by industry to be representative of small and mid-cap UK quoted companies, as derived by the London Stock Exchange. Fieldwork was undertaken by research company YouGov. Fieldwork for the November Index was undertaken between 12/09/12 and 03/10/12, and the sample size was 200 adults. The survey respondents included 74% of small and mid-cap company employees in a board level position and 45% of advisors in a senior management position.

The Select Committee will be interested to be aware that we are currently reviewing our *Corporate Governance Guidelines for Smaller Quoted Companies* (last published in September 2010), which is the industry benchmark for AIM companies, to take account of evolving best practice and, amongst other things, new legislative initiatives at UK and European level, evolution in the UK Corporate Governance Code and the Stewardship Code and the work of Professor Kay. In our update we will be incorporating the key features of the Good Practice Statement for Company Directors into the text and, more generally, promoting this part of Professor Kay's work as a helpful guide to directors and companies, along with an increased focus on the need for effective Stewardship and the benefits of all types of Diversity.

If you would like to discuss any part of our evidence in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Corporate Governance Expert Group

Edward Craft (Chairman)	Wedlake Bell LLP
Victoria Barron	Hermes Equity Ownership Services
Edward Beale	Western Selection Plc
Tim Bird	Field Fisher Waterhouse
Dan Burns	McguireWoods
Anthony Carey	Mazars LLP
Louis Cooper	Crowe Clark Whitehill LLP
Victoria Dalby	Capita Registrars Ltd
Kate Elsdon	PricewaterhouseCoopers LLP
David Firth	Penna Consulting PLC
David Fuller	CLS Holdings PLC
Clive Garston	DAC Beachcroft LLP
Nick Graves	Burges Salmon
Alexandra Hockenhull	Xchanging plc
David Isherwood	BDO LLP
Nick Janmohamed	Speechly Bircham LLP
Colin Jones	UHY Hacker Young
Dalia Joseph	Oriel Securities Limited
Doris Ko	Aviva Investors
Claire Noyce/Deepak Reddy	Hybridan LLP
James Parkes	CMS Cameron McKenna LLP
Julie Stanbrook	Hogan Lovells International LLP
Peter Swabey	Equiniti
Eugenia Unanyants-Jackson	F&C Investments
Melanie Wadsworth	Faegre Baker Daniels LLP
Cliff Weight	MM & K Limited