UK FINANCE

EY
Building a better working world

UK CAPITAL MARKETS: BUILDING ON STRONG FOUNDATIONS

May 2023

HEADLINE MESSAGES:

- **The UK remains a top tier global capital markets centre**
- **This position is being challenged and without further action, the potential for decline is clear**
- **Collective and harmonised action is required to reverse adverse trends and set the UK's markets on a new path**

WHAT NEEDS TO BE DONE?

1. **Address the structural challenges hindering UK growth companies**
2. **Reboot the nation's culture towards financial empowerment and entrepreneurship**
3. **Continue to improve 'the plumbing' of the UK's capital markets**
4. **Reinforce the UK as a destination of choice**

Click here to read the full report >>>

THE PATH FORWARD

The prevailing public discourse has started to paint a picture of the UK losing some of its attractiveness, with reports of poor performing IPOs and companies choosing to list elsewhere. Whilst the data in this report reaches different conclusions on many of the perceptions attributed to the UK's markets, our analysis has clearly identified trends that could – if left unaddressed – erode the UK's position as a leading global capital market.

Successfully delivering on the ambition to reinforce the UK's capital markets will require an honest reassessment of the fundamentals on which our markets ecosystem is built. In doing this, we can understand both the role that these fundamentals have played in getting to where we are today and more importantly how they can be optimised to ensure they continue to work for tomorrow.

Recent years have seen an industry-wide focus on enhancements to the regulation of our markets. New momentum has also now built behind efforts to strengthen the entire capital markets ecosystem, building on regulatory and legislative change. Many of the areas of focus and remedies we identified have been part of the discourse for some time, and our report should be read alongside existing initiatives – it is a complementary next step in this journey.

Call for action:

There is a pressing need for unified and collective action in order to ensure that an integrated, disciplined and holistic approach is adopted to delivering on changes. The challenges identified in this report require the ecosystem to come together. It is no small task, but the potential reward is material.

WHY DID UK FINANCE AND EY UNDERTAKE THIS WORK?

Capital markets play a critical role in supporting the UK economy. They enable and support lending and investing – from large multinational companies through to mortgages, savings products and our pensions. Having a strong and dynamic market is therefore a strategic and economic priority for the UK.

The UK is home to world-leading capital markets which bring a range of benefits, including:

- 8.3% contribution from the financial services sector to UK GDP
- A talent pool of 1.2m employees employed in financial services
- £14.7bn of equity raised in 2021 for UK and international companies
- £11.6tn assets under management (AuM) in 2021

Today, markets are changing – companies and investors have different needs and priorities. The UK has a unique opportunity to reflect, rethink and reinforce:

REFLECT:

Consider the UK's place within evolving global capital markets

RETHINK:

Identify how UK capital markets can adapt to best serve the needs of users today

REINFORCE:

Pursue measures to enhance our position as a market of choice for the decades ahead

WHAT HAVE WE FOUND? HIGHLIGHTS FROM OUR ANALYSIS

Data:

While the LSE has lagged behind the NYSE and NASDAQ regarding yearly total returns, it has outperformed in post-IPO price performance. Furthermore, the performance of UK technology sector firms choosing to trade in the US is mixed. The perceived valuation differential between companies traded in the UK and the US is not validated when looking at a group of comparable companies with similar growth characteristics; however, the declining overall average P/E ratio of the LSE is something to note.

Whilst the LSE (Main Market and AIM) remains the largest stock market in Europe, its market capitalisation declined by 6% between 2017 and 2021, with the contribution from new international company IPOs on the LSE down from 35% to 29%. The number of companies traded on the LSE also decreased by 7.4% during this period.

UK households hold 10.6% of their financial assets in equity, compared with 36.2% for US households and 22.7% for French households.

While UK asset managers allocated a higher percentage of their mandate to equity investments from 2017 to 2021 (40% in 2017 to 42% in 2021), the proportion of this invested in UK equities dropped significantly, from 30% in 2017 to 23% in 2021.

As of 2021, UK-incorporated publicly listed firms (wherever traded) had £4tn of equity. Of this £4tn, only £1.1tn was provided by UK investors, despite UK investors allocating £4.9tn to equities outside of the UK. The gap is being met by overseas investors with an appetite for UK equities.

The UK creates the greatest number of businesses per capita in Europe (one per 12.5 versus one per 17 in France and one per 25 in Germany). However, the survival rate of newly founded businesses after five years was only 38%, below that of other comparable markets.

Sentiment:

Companies ranked the key features they look for when choosing which exchange to trade on. The top five were:

- Access to a strong investor base
- Valuation and research coverage
- Liquidity in the aftermarket
- Presence of comparable companies on the relevant market
- Ease and cost of being a publicly traded company

HOW SHOULD THE UK POSITION ITSELF FOR THE FUTURE?

1

Growth companies need more help to access UK capital markets: Steps can be taken to create the best possible environment for the businesses of the future to get the growth capital they need to scale and stay in the UK.

2

UK capital does not always reach UK companies: The UK's approach to investment is driven by both structural factors (such as accounting and regulation) and cultural factors (a desire for return rather than longer-term growth). We need to begin a journey to reboot the nation's culture towards financial empowerment and reverse the trend of de-equitisation.

3

Too much friction is stifling capital flows: The UK can do more to further simplify and streamline operational processes that are placed on publicly-traded companies, and pursue measures to improve information flows in the market.

4

The UK's profile overseas needs to be improved: The UK has an opportunity to redefine how it showcases itself to global market participants. The public discourse around UK equity markets has driven negative sentiment around founders and corporate success, in sharp contrast to the pro-business environment of other jurisdictions.

For more information please contact:

Conor Lawlor
Managing Director, Capital Markets and Wholesale Policy
conor.lawlor@ukfinance.org.uk

Julie Shacklady
Director, Primary Markets, Capital Markets and Wholesale Policy
julie.shacklady@ukfinance.org.uk

Avanthi Weerasinghe
Principal, Capital Markets and Wholesale Policy
avanthi.weerasinghe@ukfinance.org.

William Clamp-Gray
Manager, Capital Markets and Wholesale Policy
william.clamp-gray@ukfinance.org.uk

Ali Campbell
Analyst, Capital Markets and Wholesale Policy
alastair.campbell@ukfinance.org.uk

CHALLENGE	RECOMMENDATION	ACTIONS TO REINFORCE UK CAPITAL MARKETS *(WHO; WHEN)*
Companies need more help accessing UK capital markets	**1** **Address the structural challenges hindering UK growth companies**	**1.1 Introduce larger and sustained tax-based incentives for R&D for targeted sectors** *(HMT, HMRC; medium-term)* **1.2 Improve investment products to help companies scale and grow**: • Expand scope of EIS and SEIS schemes and include EMIs alongside SEIS *(HMT, HMRC; medium-term)* • Require public money paid to companies through tax schemes to be repaid if the company lists outside of UK within 10 years *(HMG, HMRC; short-term)* • Develop 'growth funds' that are privately funded *(HMT, HMRC, City of London Corporation; short-term)* • Create and support public/private cross-over funds *(HMT, HMRC, City of London Corporation, market participants; short-term)* **1.3 Establish a 'Establish a 'Web Summit'-style annual conference in the UK** *(DBT, HMT, stock exchanges, trade bodies; short-term)* **1.4 Provide a glide path to becoming a traded company and beyond** • Development of a UK intermittent trading venue *(In progress)* • Develop formal communication channels between regulators, market operators, and newly-listed companies *(HMT, FCA, exchanges, trade bodies; medium-term)*
UK investment does not always reach UK companies	**2** **Reboot the nation's culture towards financial empowerment and entrepreneurship**	**2.1 Empower individuals to take personal ownership of their financial future:** • Early years engagement to emphasise importance of investing for the future e.g. via traditional and social media *(DfE; longer-term)* • Industry-supported financial literacy education programmes in schools e.g. workshops after SATS, junior ISA awareness *(DfE; longer-term)* • Establish a 'digitised gilt' supported by a government-funded marketing campaign to make gilts more accessible to retail investors *(HMT; longer-term)* • Progress work on tokenisation of securities to enable individuals, i.e. via a SIPP, to invest in a wider range of UK assets *(HMT; longer-term)* **2.2 Incentivise UK equity investment:** • Consider amendments to ISA framework to incentivise equity investment, alongside education campaigns *(HMT, HMRC; longer-term)* • Remove 0.5% stamp duty on share purchases *(HMT, HMRC; longer-term e.g. apply to traded companies)* • Progress Solvency II and DB pension reforms to removal structural barriers to equity investment *(HMT, DWP, trade bodies; medium-term)* • Progress fee cap changes in relation to DC pension fund performance fees *(HMT, DWP, trade bodies; medium-term)* • Encourage investors to focus on risk-adjusted, long-term returns *(HMG, In progress)*
Too much friction is stifling capital flows	**3** **Continue to improve 'the plumbing'**	**3.1 Continue to improve information flows in the market** *(HMT, Investment Research Review; in progress)* • Pursue reform of MiFID II unbundling rules to introduce broader flexibility for clients to choose how they pay for the research they consume • Explore appetite for market innovations to improve information provision on smaller companies or target sectors **3.2 Refresh UK indexation policies to ensure they are fit for purpose, and explore new focussed indices** *(Index providers; align with outcomes of FCA PME Review)* **3.3 Harness technology to improve market infrastructure** • Progress digitisation of UK shareholding system and full dematerialisation *(DBT, CREST, Digitisation Taskforce; In progress)* • Allow companies to communicate with investors on a solely electronic basis *(DBT, Digitisation Taskforce; In progress)* • Remove requirement for hard copies of annual reports and shareholder communications (physical upon request) *(DBT, Digitisation Taskforce; In progress)* • Flexibility for companies to choose AGM format (i.e. virtual, hybrid, or in person only) *(DBT, Digitisation Taskforce)* **3.4 Encourage global investors to vote consistently on key shareholder resolutions across international markets** *(Investor communities and representative bodies; longer-term)*
The UK's profile overseas is suffering	**4** **Reinforce the UK as a destination of choice**	**4.1 Develop 'Why choose UK equity capital markets' social media and advertising campaign** *(HMG, DBT, Industry bodies; immediate)* • Content to promote UK success stories, celebrate home-grown entrepreneurship, and encourage the public to back businesses using UK markets **4.2 Targeted incentives for companies choosing to trade publicly in the UK to offset additional costs and regulation of being public** *(HMT, HMRC; short-term)* **4.3 Proactively identify and engage with 'non-UK company' targets to showcase strengths of the UK's market** *(HMG/HMG, Industry bodies; short-term)* **4.4 Provide active support and education for non-UK companies to ensure understanding of UK listing process** *(HMG, DBT, HMT, FCA, listing venues; short-term)* • A proactive communication and advertising campaign disseminated at an appropriate time via relevant UK entities • Appoint a 'trade envoy' for UK capital markets to join broader UK trade delegations **4.5 Applying, where appropriate and on a targeted basis, deference mechanisms to reduce unnecessary duplication of legal and regulatory requirements for international companies and companies with listings in more than one jurisdiction** *(HMT, FCA, exchanges; longer-term)*

UK FINANCE EY