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Capital Issues: Reforming the UK's Capital Markets to Boost Science and Tech

TONY BLAIR INSTITUTE FOR GLOBAL CHANGE

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Our Future of Britain initiative sets out a policy agenda for governing in the age of AI. This series focuses on how to deliver radical-yet-practical solutions for this new era of invention and innovation – concrete plans to reimagine the state for the 21st century, with technology as the driving force.

This report is a joint publication by the Tony Blair Institute for Global Change and Onward.

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Foreword

The UK is one of the most exciting countries in the world to discover, invent and build. With its leading startup and investment ecosystem and some of the best universities globally, it should be striving to be the home of Europe's first trillion-dollar technology company.

But the UK risks falling by the wayside in the global science and technology race because of its chronic inability to support scale. As leaders of some of the UK's most successful emerging science and technology businesses, we know only too well the obstacles and difficulties that are being experienced by growing British companies.

One of the most pressing reasons for these is the UK's capital markets. Put bluntly, its public markets are not fit for purpose. Bold reform is needed – and needed now. Every day, the global race to discover and bring to market the innovations of the future gathers pace. If the UK does not revitalise its markets, invention and talent will go elsewhere.

The findings in this report set out the stark challenges facing UK markets, such as the chronically low levels of institutional investment and the growing regulatory burden faced by businesses and investors. The government should look seriously at this report.

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Executive Summary

The UK's capital markets are in trouble. London was once the world's largest stock exchange, and today, it ranks sixth. Over the past ten years the value of the S&P 500 (the index of the top 500 companies listed in the United States) has grown ten times faster than the United Kingdom's FTSE 100. Last year 76 firms delisted from the London Stock Exchange's (LSE) growth market, AIM (formerly known as the Alternative Investment Market) – up 62 per cent on the previous year. And scores of leaders of the UK's most vibrant companies have publicly stated that they would not consider listing on London's exchanges. Low liquidity, diminished investor confidence and a shrinking pool of capital available are compounding the exodus.

The implications for the UK's financial markets are severe. Failure to address these issues risks an irreversible decline in the UK's status as a global financial hub and could extinguish Britain's potential to be the home of the next wave of world-leading science and tech companies, hindering its growth prospects for decades to come. Without a robust public capital market that caters to high-growth tech companies, the UK will continue to have its brightest startups relocate or sell out to foreign competitors, taking with them the copious amounts of talent, revenue and value creation they promise.

But Britain can regain its edge. There are a growing number of startups prime for going public: Europe now has more than 1,500 startups that are each generating over $25 million in annual revenue. More than 250 of these are generating $100 million to 500 million in revenue – almost half of which are UK-based. If London plays its cards right, it can become the place of choice for this next generation of scaling European tech companies while providing a platform and financing pathway for the UK's first trillion-dollar tech company.

Fixing London's capital-market issues will not be easy. First, what is causing London's decline is poorly understood. The traditional tale is that the decline is driven by too little being invested in the UK's biggest companies – and persistent discounts to their share prices (that is to say, lower valuations for

firms trading on the LSE compared to those listed on other exchanges). In this telling, if only London had more investors or more money for its biggest companies, then the City's fortunes would be restored. However, while there is some evidence of small discounts for firms trading in London, this oversimplification does not capture the full picture of London's underperformance.

Instead, London's challenges are being caused by three interlinking issues:

First, while not the sole factor, there is indeed a lack of institutional investment in large private and newly public companies with high growth potential, but this is different to the traditional focus on driving money into established, larger public companies. The advantage held by the US has been overwhelmingly driven by the "magnificent seven" – US tech giants such as Google and Amazon whose shares have swelled in value. Without these seven firms, there have been long periods where American shares have actually traded at a discount relative to British ones. But the UK, and therefore its stock market, has failed to be the home of the fast-growing companies of the future, leaving the FTSE dependent on legacy firms such as those in financial services and natural resources that do not have the growth potential of the technology sector. Central to this is the UK's inability to invest at appropriate levels. Institutional risk-aversion within the UK's pension and insurance systems has caused chronic underinvestment in both private and public markets.

Second, there are specific factors reducing investment in smaller public firms, beyond broader issues related to pension funds or insurers. In the UK, investment in smaller firms tends to come from smaller investment funds. But these funds are in decline, primarily due to regulatory burdens that have increased compliance costs and made smaller funds less viable. The proportion of small British investment funds compared to larger ones has more than halved over the past 15 years. At the same time, passive investment strategies – where asset managers invest in composite indices rather than specific companies – have increased, meaning less is invested in smaller firms outside major indices such as the FTSE 100.

Third, the public-listing environment is unfavourable for smaller firms. Low

liquidity and insufficient professional-analyst coverage – mid-sized AIM firms have on average a quarter of the analysts covering their US equivalents – are making small and medium-sized listed companies unattractive investment propositions. UK defined-benefit pensions are not only investing less in public markets but are also withdrawing from equity funds, reducing participants and capital in new, innovative companies. This results in lower liquidity for smaller listed firms, making them less appealing to investors and making it harder to raise funds.

To reclaim its status as a global financial hub, London needs radical transformation. London's ambition should be to become the premier public exchange for high-growth tech companies focused on European customers that are too big to stay private in the long term. The LSE has made some important positive steps, but more must be done. This requires bold and broad-ranging reform:

- **Close down AIM and create a rapid route to listing on the LSE's Main Market with similar, but time-limited, tax and regulatory benefits.** AIM has failed in its stated purpose of providing a home for scaling businesses. It should be fully merged with the LSE's Main Market, with a special route to listing specifically for high-growth firms in emerging technology sectors. In this way, London can differentiate itself from other global exchanges and attract a pipeline of high-quality, innovative companies. Tax benefits for investors, similar to those currently available for AIM-listed companies, should be retained for firms using this route.
- **Fix listing challenges and revamp the Private Intermittent Securities and Capital Exchange System (PISCES).** The government should take advantage of the London Stock Exchange Group's planned intermittent trading venue for private companies and design it to attract institutional investment in growth firms and initial public offerings (IPOs). This could be through mechanisms to de-risk investment such as giving an indicative time period for a future IPO.
- **Expand and enhance the capacity of the UK's investment sector.** Pre-IPO companies need large-scale (tens of millions of pounds) investment that the UK's venture-capital ecosystem is not well-suited to providing. The UK government should earmark £1 billion of funding to invest in five

growth-focused venture funds, crowding in institutional capital to create a generation of UK-based large-scale growth investors. The UK also has fewer brokers and equity-research analysts per head compared with the US. The government should make an advance market commitment to act as an anchor purchaser to support the rapid expansion of this industry, as it did with vaccine rollout during the Covid-19 pandemic.

- **Cut regulatory red tape and bureaucracy in compliance and governance burdens on asset managers and listed companies.** Reforms to the regulatory and compliance burdens placed on asset managers would support greater institutional investment in public markets by lowering the barriers to entry for new asset managers, increasing their allocation to smaller companies and lowering their cost of business.

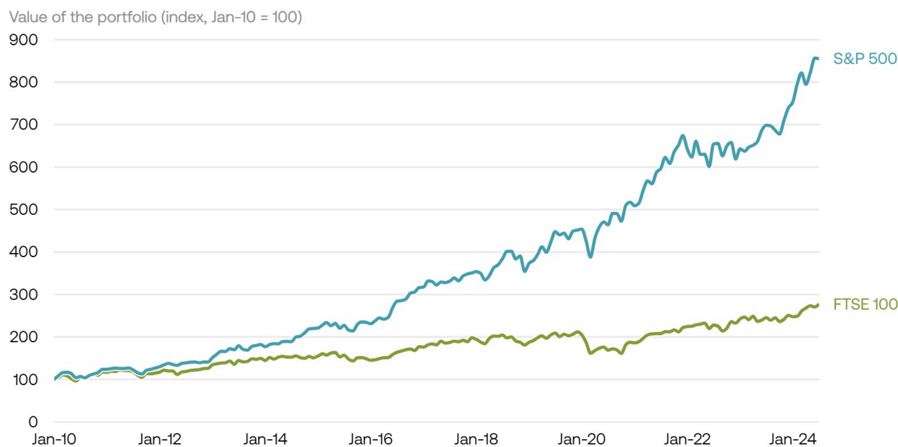
London must fill the gap in the global public markets and position itself as the go-to public exchange for the next generation of European scaling tech companies. If it succeeds, the UK can attract the best and brightest, foster innovation, replace the previous generation of companies and secure its economic future. This transformation is not just about saving the LSE – it's about securing the long-term prosperity of the UK.

03 Britain's Markets Are Falling Behind

Over the past decade, the UK's biggest companies – as well as its economy overall – have failed to keep pace with their global counterparts, particularly those in the United States and other leading economies. The FTSE 100, the index comprising the UK's 100 largest publicly listed companies, has increased in value by about 20 per cent from 2015 to October 2024.[1] In contrast, the S&P 500, which contains the 500 largest companies listed in the US, has grown more than 250 per cent in the same period[2] – over ten times as fast.

FIGURE 1

Growth in the S&P 500 has outstripped the FTSE 100 in recent years



Source: Curvo.eu, FTSE 100 vs S&P 500: historical performance from 2000 to 2024

Much of the blame has been levelled at the UK's financial markets and its main exchange, the London Stock Exchange (LSE). There have been

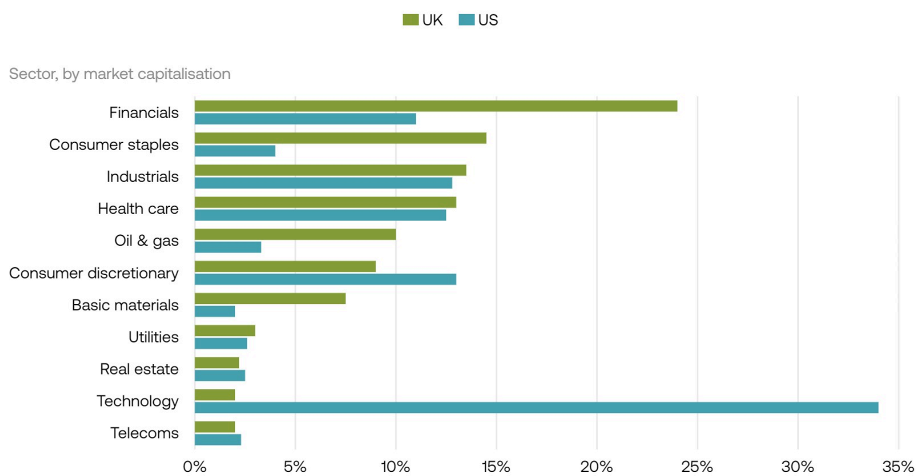
frequent accusations that this poor growth is because the stock prices of firms listed on the UK's markets are consistently undervalued.[3] The Financial Conduct Authority (FCA) has claimed that the media coverage itself is exacerbating the issue.[4] In this overall telling, a combination of bad media coverage and unfair, low valuations is holding back the UK's most successful companies, damaging its stock exchange and increasing the cost to firms of raising capital.

But this criticism is at best incomplete. The lacklustre performance of the UK's main index is not the result of mysterious financial-market discrimination; it is caused by the same factors that are undermining the wider UK economy. The UK's financial markets are suffering from the same structural problems plaguing other parts of the economy, ranging from public services to transport infrastructure: a failure to invest and modernise. In the National Health Service, this manifests itself as doctors relying on outdated computer systems for routine tasks. In transport, the UK rail network has starkly lower rates of electrification than European Union countries – 38 per cent in the UK compared to an EU average of 60 per cent.[5] And in UK financial markets, the lack of modernisation manifests in the persistent failure to foster large, dynamic and well-funded firms in the high-growth sectors of the future.

This failure to modernise and foster innovation is evident in the composition of the UK's public markets. Firms from established, slow-growth sectors make up a larger proportion of the UK's public markets than those in other countries, such as the US. For instance, technology firms tend to grow far faster than traditional financial-services firms, which are over-represented in UK markets. Barclays, for example, has a roughly similar total market capitalisation today as it did ten and 20 years ago.[6] Google, on the other hand, has increased its total value roughly over five-fold in the past decade.[7] The UK markets' dearth of publicly listed technology companies can be seen in Figure 2, which shows the size of sectors in the UK compared with the US stock market.

FIGURE 2

UK public markets over-represent financial-services firms and under-represent technology companies compared to the US



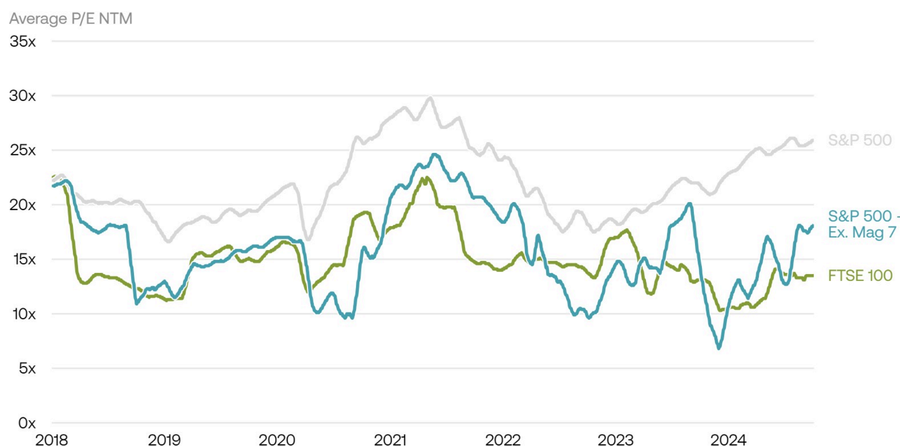
Source: Panmure Liberum, shared with TBI and Onward

The implication of this trend for the valuation and performance of the UK stock market overall is stark. If the proportion of the UK's stock market composed of technology firms were equivalent to the rest of the world's, the value of the average UK share would be around 20 per cent higher.[8]

The overperformance of US indices relative to the UK can be explained in large part by the presence of the "magnificent seven" – the seven biggest technology companies in the US.[9] Figure 3 shows that excluding these seven shares from the price-to-earnings ratio for shares (the value of the share in relation to the company's earnings) in the S&P 500 eliminates much of their advantage over the shares in the FTSE 100. Without these seven companies, there have been long periods where the S&P 500 has in fact traded at a lower price-to-earnings ratio than the FTSE 100.

FIGURE 3

How big tech companies (the "magnificent seven") boost the S&P 500 compared to the UK's FTSE 100 (2018–2024)



Source: FactSet. Note: Average P/E (NTM) refers to the average price-to-earnings ratio based on earnings from the last 12 months. Ex. Mag 7 means excluding the magnificent seven (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla).

The performance of the share prices for the magnificent seven is not just explained by their core products. Consider artificial intelligence: Microsoft is a major investor in OpenAI; Google owns DeepMind; Anthropic has received billions of dollars in investment from both Amazon and Google. As a result, the share performance of the mega-cap tech companies (very large technology companies with market capitalisations typically exceeding $200 billion) essentially captures and reflects the value of innovation across the entire technology sector.

The primary cause of the UK's public markets falling behind the US is not a bias against UK PLC. Instead, while the UK economy remains dominated by companies from traditional, low-growth industries, the US economy

generates stronger, more vibrant and future-focused tech firms that then drive their domestic stock markets' performance.

Boosting the FTSE 100's performance therefore does not rely solely on listings reform, although it must play a part. Instead, a key element of the UK's growth must come from creating a supportive funding environment for high-growth firms that can replace the previous generation of companies at the top of its public markets.

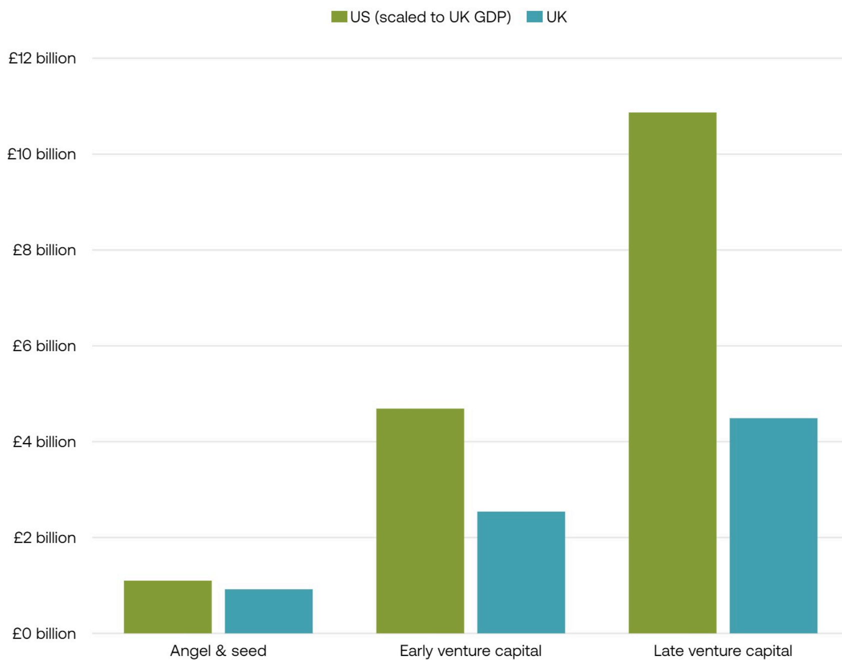
The Failure to Modernise the UK Economy

The UK has had a chronic inability to support the development of modern, high-growth businesses. Despite having a trillion-dollar tech sector,[10] the UK has only two companies in the top 100 companies by R&D expenditure.[11] As Onward and the Tony Blair Institute for Global Change have both argued before,[12] this is primarily a consequence of the UK's failure to finance scaling companies with growth capital.

Figure 4 shows that, adjusted for economy size, US late-stage venture capital is almost double the value of the UK's despite roughly equivalent values invested at the angel and seed stage. The UK's under-investment in later-stage growth directly impacts the pipeline of successful technology firms for its public markets (known as Initial Public Offerings, or IPOs). Less than half of Britain's most innovative firms reach their second funding round, far fewer than the 63 per cent of American ones.[13] Evidence from 2016 to 2020 also shows UK firms that engage in R&D-intensive activity were disproportionately bought by overseas acquirers. For companies in R&D-intensive sectors, 59 per cent of UK acquisitions were by foreign companies – higher than for other sectors.[14]

FIGURE 4

The UK's late-stage venture-capital gap compared to the US (adjusted for economy size)



Source: British Business Bank and National Venture Capital Association (NVCA) data from 2015 to 2021

Many of these R&D-intensive companies that fail or are acquired by foreign investors should instead be the pipeline of successful IPOs on the LSE – driving investment activity and renewing the UK's indices. Instead, they are unable to find funding in the UK, and disproportionately end up purchased by foreign (often American) competitors.

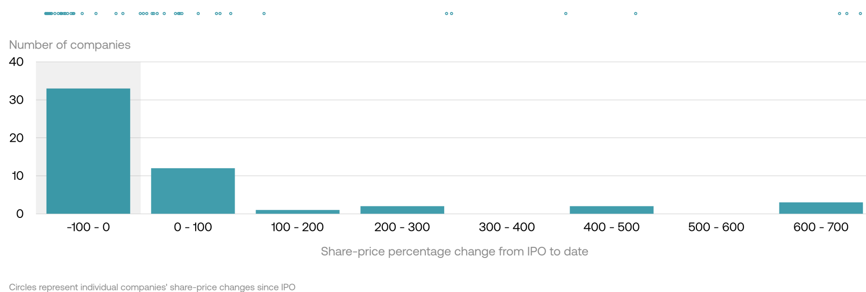
UK Tech Can't Rely on the US for Funding

US markets are not a substitute for a functioning UK market. While the US may be a suitable place to list for some European firms, many struggle.

Excluding IPOs from 2023 or later, the share prices of European firms listing in the US since 2015 have had a median performance since IPO of -72.9 per cent (Figure 5), meaning that their shares are now worth less than one-fifth of their initial price. Far from guaranteeing a share-price rise and plentiful investment for European companies, a US IPO is more frequently associated with a significant fall in value. This evidence is consistent with testimonials from investors, bankers and founders we have spoken to.

FIGURE 5

European companies tend to struggle after listing on US stock markets

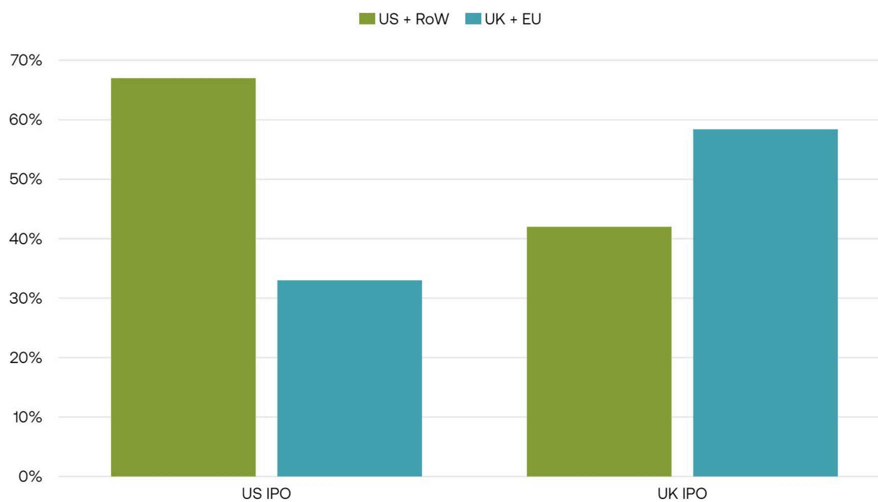


Source: Dealogic, FactSet

The UK firms that list in the US tend to already have a significant proportion of their revenues coming from the US. Figure 6 shows that the UK firms listing on the New York Stock Exchange (NYSE) or the Nasdaq tend – at the point of IPO – to have far more revenue coming from the US and the rest of the world than Europe (including the UK). For comparable firms listing on the LSE, this dynamic is reversed.

FIGURE 6

UK firms that list in the US tend to have significant revenue outside the UK and Europe when they IPO



Source: Company IPO filings analysed by Onward/TBI

While revenues alone are not likely to be decisive, UK firms listing in the US at present already have a significant client base overseas, likely compounded by years of US investment and American board members.

If UK firms were to instead start listing on the NYSE or Nasdaq en masse, regardless of the fundamentals necessary for fundraising, their performance would likely be limited by practical obstacles (such as existing relationships with investors and time zones) that would make a US listing less likely to be successful. A deep reliance on US equity markets to capitalise UK firms, therefore, is not a viable long-term option.

GAP IN THE MARKET: LONDON SHOULD BE EUROPE'S PREMIER MARKET FOR SCALE-UPS

Despite the challenges, there is nonetheless a growing number of British and European startups prime for going public. Europe now has more than 1,500 startups with over $25 million in revenue. There are 263 startups with revenues of $100 million to $500 million across major European tech hubs – 118 of which are UK-based.[15]

But many do not view London, or any other exchange in Europe, as a route to furthering their growth ambitions. Last year 76 firms delisted from London's growth market, AIM – an increase of 62 per cent compared to 2022.[16] This trend is part of a broader decline in AIM listings, with the number of companies listed on AIM falling 30 per cent from 1,104 in 2015 to just 742 at the end of February 2024.[17] When UK AI cyber-security firm Darktrace was acquired earlier in 2024, it cited valuation challenges as a reason for delisting.[18] Nik Storonsky, founder of UK fintech Revolut, has said he does not "see the point" in listing in London.[19]

With the US being a poor option for many UK and European companies, there is an opportunity for London to assert itself as the home of small and middle-capitalisation (smid-cap) European startups looking to go public. This refers to businesses with a market capitalisation (total value of their outstanding shares) typically ranging between $500 million and $10 billion. If the UK is to achieve this, it must address the myriad structural challenges holding it back – including fixing its leaky pipeline of scaling tech companies to build liquidity.

04

How the UK Stymies Scale-Ups

A stronger pipeline of scaling companies is vital for the UK's capital markets. But UK firms are deprived of the capital needed to feed their ambitions. While recent reforms have made improvements,[20] they are not enough on their own to address the UK's overarching problems. These are:

1. Lack of institutional investment in large private and newly public companies
2. Specific barriers causing low investment in smaller public firms
3. Unfriendly public-listing environment for companies

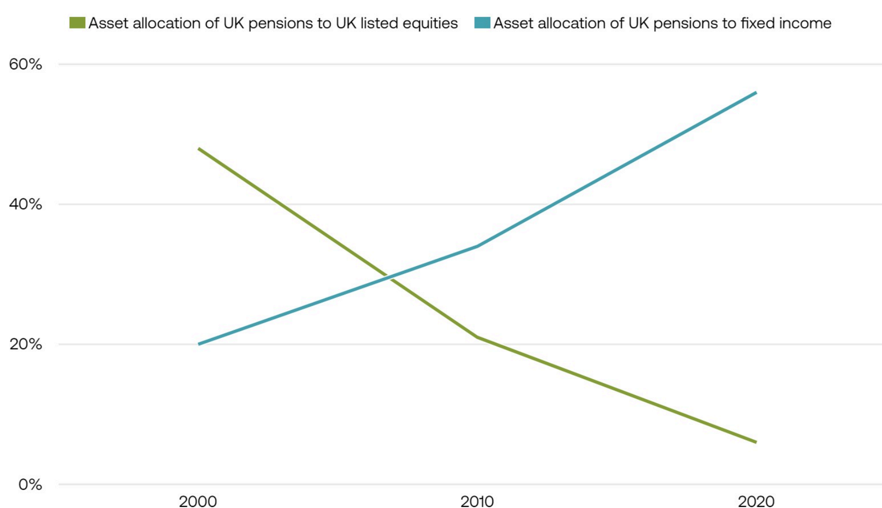
Lack of Institutional Investment

Underinvestment is most significantly caused by institutional risk-aversion by the UK's pension and insurance systems. In the US, pension-fund capital is a primary driver of growth-capital investment, powering 72 per cent of the venture-capital sector as opposed to just 10 per cent in the UK.[21] The lack of investment means the pipeline of promising UK companies is significantly constricted before firms can consider going public, contributing both to the lack of innovative companies scaling in the British economy and to the underperformance of the FTSE.

This, combined with the withdrawal of defined-benefit (DB) pension assets from the UK equities market (Figure 7), has meant a significant restriction in capital flows in the UK's capital markets. The dynamics of this de-equitisation have been described elsewhere,[22] but have broadly been driven by regulatory changes and the increasing age of the average DB-scheme member, meaning DB schemes are increasingly focused on low-risk fixed-income investment strategies.

FIGURE 7

Pension capital is retreating from UK equities



Source: New Financial

Low investment in smaller public firms

Actively managed smaller funds are a significant driver of IPO activity and liquidity in the shares of firms too small to be included in indices such as the FTSE 100 and FTSE 250. Data from the LSE show that the investment in smaller UK companies is far more driven by smaller investors than ownership of larger UK companies, with 91 per cent of LSE Main Market shares being owned by non-institutional investors, compared with just 61 per cent for the FTSE 100.[23]

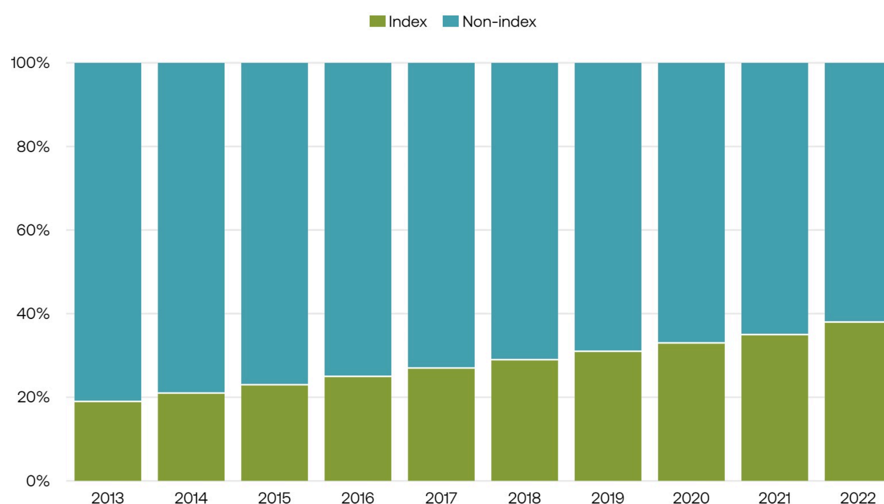
However, the number of such UK investors has been steadily dropping. The proportion of small UK investment firms (those with less than £1 billion in assets under management) has more than halved in the past 15 years, from just above 20 per cent to just below 10 per cent.[24]

At the same time, the market has also seen the growth of passive

investment strategies, in which asset managers invest in composite indices of shares, rather than making active decisions about specific companies to buy and sell. A direct consequence of a passive investment strategy is that smaller listed firms outside the index are not included in these funds, meaning listed firms not big enough to be a part of the FTSE 100 or 250 are not eligible for this kind of investment. Moreover, 98 per cent of the value of the FTSE All-Share index comes from firms in the FTSE 100 and FTSE 250, meaning it is not an option to drive investment into smaller firms.[25] As shown in Figure 8, the rise in passive investing in the global market from 19 per cent in 2013 to 38 per cent in 2022 has contributed to this trend, leaving smaller companies with less investment. The growth in passive investment therefore entails less money for smaller firms.

FIGURE 8

The rise of passive investment in the global market (2013–2022)



Source: Peel Hunt

Small, innovative companies looking for capital on the UK's public markets

are therefore caught in a vice. On the one hand, the growth in passive investment management means that many sources of capital are simply inaccessible. On the other, small asset managers that would normally invest in such companies are increasingly rare.

A key driver of this is red tape making smaller funds increasingly unviable. Other long-term trends add to the challenge – such as the aforementioned withdrawal of pension money from UK financial markets, and an uptick in mergers and acquisitions bringing these funds together. But more important is the expansion of regulatory burdens, including both extensions of existing regulations and the introduction of new ones, such as:

- **The Senior Managers and Certification Regime**: extended to asset managers after 2019. It is aimed at strengthening accountability for conduct and competence within financial-services companies and has compliance requirements before senior managers can be appointed.
- **The 2020 Stewardship Code**: intended to promote good practices among those investing money on behalf of UK savers. It requires annual reporting and dedicated resources.
- **Anti-money-laundering (AML) regulations**: expanded to impose more stringent compliance obligations on firms to ensure that they are not involved in financial crime. These require risk assessments, monitoring and training. The UK's AML-compliance costs are seven times higher than the US when adjusted for economic size.
- **Oversight of liquidity requirements**: made more stringent after 2019, resulting in fund managers refraining from investing in small, illiquid firms for fear of regulatory action.
- **Markets in Financial Instruments Directive II (MiFID II)**: introduced in January 2018 as a set of EU-derived laws that regulate the buying and selling of financial assets. The regulations have been associated with a 20 to 30 per cent decline in buy-side budgets for equity research[26] and a substantial decline in analyst coverage on the LSE Main Market.[27] The FCA recently reversed the "unbundling" requirements of MiFID II, in which firms had been required to charge separate execution and research fees.[28]

Conversations with asset managers, brokers, investors and lawyers

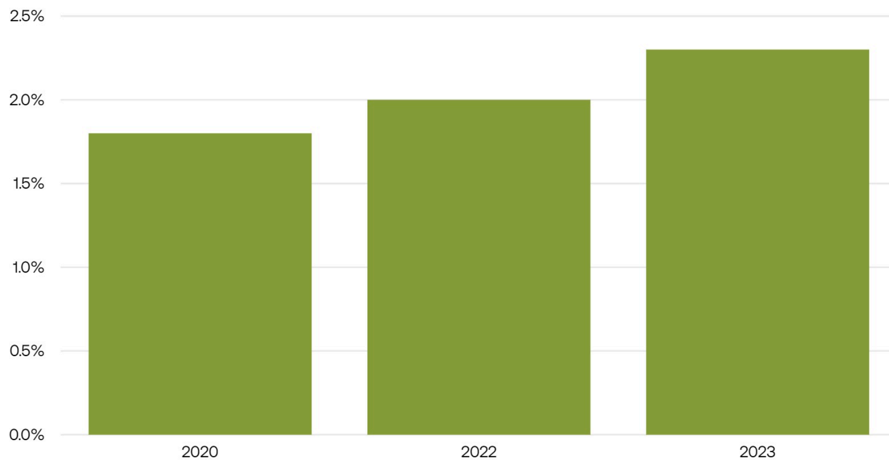
repeatedly point to a single source of frustration: risk-averse over-regulation by the UK's institutions, which has incrementally raised costs for financial-services firms, rendering their business model less financially viable.

All of these regulations are defensible in principle and are intended to achieve desirable public-policy outcomes. AML regulations, for instance, are intended to reduce incidences of financial crime. However, a recent report estimated the total 2023 compliance cost of AML regulations borne by the UK's financial-services industry at £38.3 billion[29] – roughly 1.5 per cent of the UK's entire GDP and approximately seven times higher than the US, adjusted for economic size.[30]

For smaller asset managers, those with approximately £300 million assets under management, the annual cost of AML compliance alone has risen to the equivalent of 2.3 per cent of each firm's assets under management. This is an increase of 28 per cent since 2020, or 8.5 per cent per year.

FIGURE 9

The cost of anti-money-laundering measures has increased significantly for smaller asset managers



Note: 2021 data unavailable

Source: Oxford Economics

Even the FCA is not sure that the regime is working effectively, despite a regulatory environment in which firms are compelled to spend more than £30 billion each year. In March 2024 the regulatory body published an open letter claiming that firms had often "lacked sufficient detail, and the methodology used [for AML assessments] was unclear" as well as "a failure by some firms to document how they have responded to risks".[31]

CASE STUDY

Stewardship Code 2020

As of February 2024, there were more than 270 financial-services firms signed up to the Stewardship Code, a voluntary code of standards for UK investors issued and updated by the Financial Reporting Council (FRC).[32] The FRC is a non-government regulator established by the Companies Act 2006. Firms that fall under the FRC's regulatory remit are required to make a financial contribution to the FRC, regardless of whether they choose to sign up to the voluntary Stewardship Code. Its board is appointed by the secretary of state for business and trade. In the words of the FRC, the Stewardship Code is intended to foster "responsible allocation, management and oversight of capital to create long-term value".[33]

According to the FRC's own review, the 2020 Code forced 96 per cent of companies who follow the code of standards to increase their staff costs, and almost three-quarters of signatories had to increase their research costs.[34] A sample of annual stewardship reports for firms subject to the Code averaged at 65 pages long.

The 2020 code is currently under review by the FRC, with a new version likely to be issued later this year.

Some reforms have already been made by the FCA and LSE with a view to lowering costs and making listings easier, such as the growth objective,[35] implementing the 2023 Investment Research Review,[36] the ongoing reform to the prospectus regime and changes to the Listing Rules.[37] Nevertheless, the Investment Association (IA) has called the recent expansion of

regulatory requirements "unprecedented".[38] In last year's annual report, the IA quoted one investment manager who said, "The UK part of the business is about one third of total assets under management and revenue of the global business, but my regulatory bill is around four times the rest of the organisation."

Unfriendly Public-Listing Environment

The UK's public-listing environment is not working properly for small and medium-sized companies, both those already listed and those seeking to list on the stock exchange. These firms are often unattractive propositions for investors because key conditions necessary for investment – such as liquidity and the presence of professional analysts – are not present in the UK.

The poor listings environment is caused in significant part by the fact that UK pensions, including DB schemes, are investing less in UK public markets. According to the Office for National Statistics (ONS), the overall ownership of UK quoted shares by insurance companies and pension funds combined had fallen to approximately 4.2 per cent by 2022, the lowest proportion jointly held by them on record.[39] Additionally, these institutions are also withdrawing from equity funds, a type of investment fund that focuses on a category of asset that includes shares in publicly listed companies. UK equity funds have been experiencing withdrawals at an average of almost £1 billion per month for the past seven years.[40]

This, combined with the reduction in the number of active, smaller asset managers, has reduced both the number of participants who trade in new and innovative companies, and the amount of money they have to trade with. The overall result is that "liquidity" – the ability of a market to permit large values of a share to be traded without the price changing – is now far lower for smaller listed firms. This is a serious issue, as liquidity is a critical factor considered by fund managers when deciding whether and how to invest.

Firms that are in the large indices – for instance the FTSE 100 and FTSE 250

– have high levels of daily trading and relatively stable prices. But firms listed on the main market that are too small to be on the index, or are listed on AIM (a smaller exchange within the LSE), often have very low liquidity and trading volumes. This makes them less attractive to investors and makes it harder for them to raise money.

AIM

AIM is a stock exchange within the London Stock Exchange Group which is targeted towards "small and medium-size growth companies".[41] Firms that list on AIM are frequently smaller than those on the LSE's Main Market, and there are looser criteria to be eligible for AIM than for the Main Market.[42]

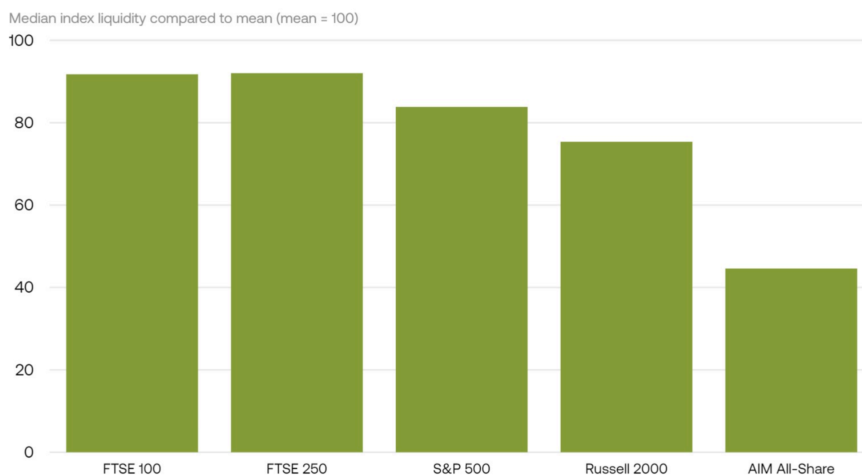
AIM was started in 1995. As of September 2024, it has 704 companies listed, with a total capitalisation of £48 billion as of October 2024.[43] By comparison, the LSE's Main Market has a total capitalisation of £4.4 trillion listed on it.[44]

This dynamic – where large firms are very liquid, but smaller ones far less so – can best be seen in the difference between mean and median liquidity on different indices (such as the FTSE 100, which has the 100 largest companies on the LSE Main Market, and the AIM All-Share, which is all companies listed on AIM). This is a measure of the consistency of liquidity across the index. As can be seen in Figure 10, median AIM liquidity is 45 per cent of the index's mean liquidity: far lower than the other indices measured. This suggests that mean liquidity in AIM is elevated by a small number of

extremely liquid shares, with the average company having much worse liquidity than the mean, and especially worse than those right at the top. This is consistent with complaints we have heard from CEOs and other market participants.

FIGURE 10

Liquidity on AIM is far less evenly distributed than on the FTSE 100 or S&P 500



Source: Bloomberg

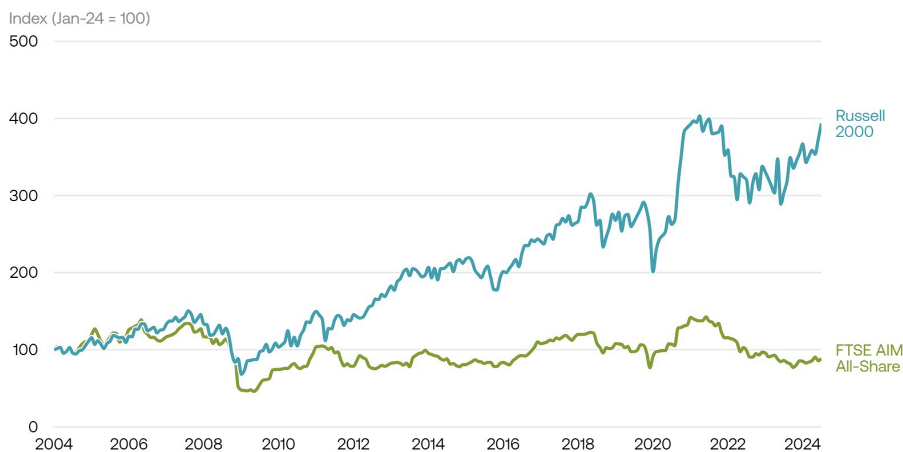
Liquidity matters for investment managers, as it is one of the regulated metrics they are obligated to manage for their funds. One consequence of low liquidity on AIM shares is that active investors concerned about liquidity management are less likely to buy them. One CEO of a formerly publicly listed firm told us that they were unable to raise money from investors by issuing primary shares because their share price on AIM was too volatile, meaning that they were not a reliable target for investment.

Investors being unwilling to put money into AIM-listed companies as a result of low liquidity is a serious structural barrier to the market serving its stated function for "dynamic high-growth companies"[45] and results in a downward spiral: low liquidity for firms means they are traded by fewer asset managers, lowering liquidity further.

Not only does this lack of liquidity mean that AIM companies find it harder to attract investment, it also damages its attractiveness to high-growth firms considering listing. This has contributed to AIM's underperformance overall relative to the Russell 2000 over the past 20 years – as seen in Figure 11.

FIGURE 11

Underperformance of FTSE AIM All-Share relative to Russell 2000 due to liquidity challenges (2004–2024)



Source: LSE and MarketWatch

AIM's failure to provide liquidity for its listed firms is exacerbated by the low number of investment-bank equity-research analysts covering each company relative to similarly sized companies in the US. Higher analyst

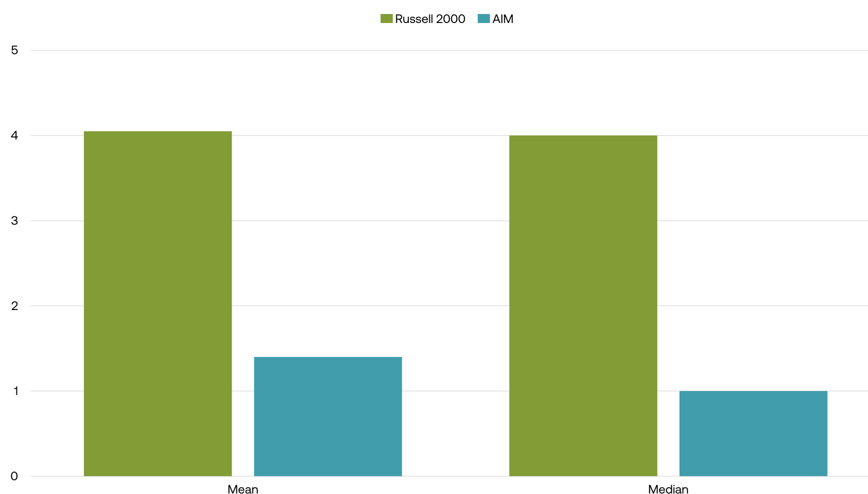
coverage for a particular share is associated with increased liquidity.[46, 47]

The average number of analysts per S&P 500 and FTSE 100 company is 23 and 18, respectively.[48] But for smaller firms listed on the Russell 2000 and AIM, there is a significant drop-off in the amount of analyst coverage from the US to the UK, even when the firms are the same size. For companies with a market capitalisation between $50 million and $500 million, the mean number of analysts looking at these companies on the Russell 2000 is just over four, with a median of four. AIM companies of this size, on the other hand, have far fewer than equivalently sized US companies, with an average of only one analyst covering them.

For all companies listed on AIM, the median number of analysts per company is zero, meaning that the majority of AIM companies do not have a single analyst looking at them at all.

FIGURE 12

Companies with market cap of $50 million to $500 million have far fewer analysts on AIM than the Russell 2000



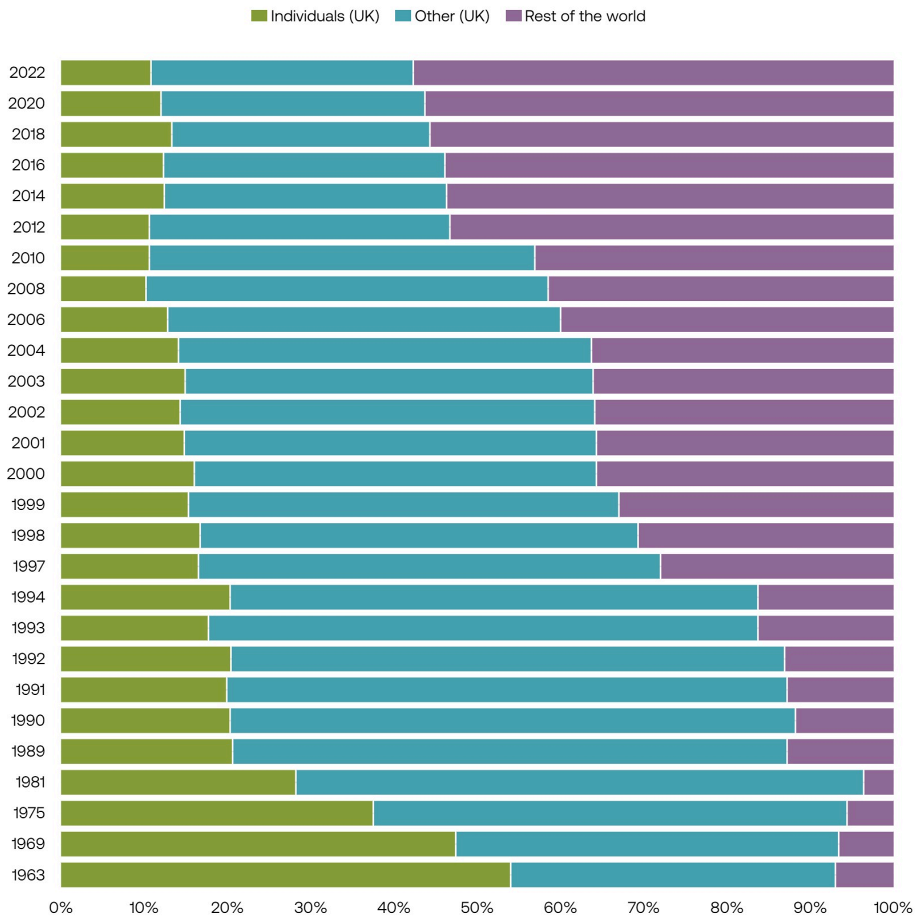
Source: Bloomberg

We also heard concerns from CEOs regarding the compliance burden on disclosures, as well as the time taken to complete the listing process. It frequently takes longer than four months to list on AIM according to institutions[49] and advisors, far longer than the six-week timeframe for the Nasdaq.[50] Taken in combination with low liquidity, it is clear that AIM no longer provides the right conditions for scale-ups to find funding and grow.

But the causes of low liquidity for small companies also hurt larger companies on UK public markets. In addition to a lack of investment in smaller companies, the withdrawal of domestic investors from listed UK companies has resulted in larger public UK firms being majority owned by foreign investors. As can be seen in Figure 13, non-UK investors have grown from constituting less than 20 per cent of the UK's listed companies in the 1980s and 1990s to well over half today.

FIGURE 13

The rise of overseas ownership in UK public companies (1963–2022)



Source: ONS; Note: Data show beneficial owners of UK quoted shares by subsectors, 2022

Evidence suggests that the large proportion of foreign investors in FTSE companies is directly connected to low levels of UK CEO pay relative to the US,[51] further damaging the ability of large UK companies to attract senior talent and grow.[52] This is because non-domestic investors are more likely to rely on guidance from proxy advisors, who analyse company performance and make recommendations on investor behaviour, for binding votes on

executive pay.[53] These advisors have been found to take an "inflexible approach to compensation stewardship", pressing downward on UK CEO pay and subsequently reducing UK competitiveness.

This tallies with the complaints of the directors of public companies, who have vocally criticised these advisors for their rigid approach.[54] Put simply, a lack of domestic institutional investors has – through the behaviour of international investors – likely damaged the quality of corporate leadership in the UK's biggest firms.

In summary, the UK's public-listing environment is demonstrably unfavourable for small and medium-sized companies, both those already listed and those seeking to list. This unfriendliness stems from a confluence of factors: diminished liquidity due to the withdrawal of UK pension funds from equity investments, a reduction in the number of active smaller asset managers, insufficient analyst coverage (particularly for AIM-listed companies) and burdensome compliance requirements. These issues have led to underperformance of the AIM relative to comparable indices like the Russell 2000, discouraged new listings and made it challenging for listed companies to raise capital. Moreover, the increased proportion of foreign ownership in larger UK-listed firms has potentially impacted corporate governance and executive-compensation practices, further complicating the landscape for public companies in the UK.

05

Delivering Strong UK Capital Markets by 2030

The major markets in the US (the NYSE and the Nasdaq) are based in New York City. Yet some of the firms they provide capital and liquidity for are headquartered thousands of miles away in California – or outside the US altogether – and have operations spread across the entire world. There is no reason why the UK's capital markets should have a lower ambition. In fact, for the UK to avoid losing its best talent, entrepreneurship and technology to the US gravitational orbit, and to achieve its full economic potential, delivering on this ambition is not optional.

The opportunity for the UK is enormous. If the issues highlighted – chronic underinvestment, persistent over-regulation and a lack of modernisation – were addressed, the UK's markets could be the natural home for scaling science and technology businesses based in the UK and across Europe. In the long term, this would mean the growth of larger companies in the UK's technology sector – with less business failure or brain drain to the US – supporting jobs, innovation and economic growth.

In order to achieve this, the UK will need to deliver the following over the next five years:

- A large-scale deployment of domestic institutional capital into UK-based growth equity and small-cap listed companies, resulting in a steady stream of UK-based IPOs in high-growth sectors on a reformed public exchange.
- A robust ecosystem of small and medium-sized asset managers, investing in IPOs and other listed firms that are too small to be included in indices like the FTSE 250.
- A significant expansion of the associated ecosystem of financial professionals involved in deal origination and advisory, including equity analysts and large-scale venture-capital investors with scientific expertise.

In practical terms, the framework below sets out how these deliverables can be achieved. The first two recommendations focus on increasing the availability of capital for high-growth UK firms (both private and public) and growing the supply of associated financial infrastructure that supports the placement of that capital. The third relates to the regulatory conditions in which these firms operate: attempting to break the cycle of increasing regulator-imposed obligations on investors. The final three recommendations set out how the UK's financial markets can be reformed, and how the UK's economy can achieve its potential.

CASE STUDY

Hong Kong Stock Exchange: How New Rules Drove Success in Biotech

The UK's financial markets are clearly no longer achieving one of their primary objectives: delivering sufficient financing to growing companies that have decided to list. To address this, the UK can learn from a recent international success story – Hong Kong, which managed to revitalise its domestic market through targeted and effective reform.

While the UK has implemented significant reforms to its listing regime,[55] Hong Kong's approach offers valuable insights for strategically important technology sectors. Hong Kong's targeted focus, particularly in biotech, demonstrates how sector-specific policies can attract and retain pre-revenue, R&D-intensive companies. Given biotech's strategic importance to the UK, this example illustrates the potential impact of tailored policies in capturing high-value, innovative companies, and provides instructive lessons for enhancing the UK's market appeal across its diverse high-potential technology sectors.

The Hong Kong Stock Exchange (HKEX) has successfully expanded its listing regime to accommodate pre-revenue biotech companies and those with weighted voting rights (WVR) structures. Through the introduction of Chapter 18A for biotech listings and Chapter 19C to its Main Board Listing Rules, HKEX has positioned itself as a competitive destination for innovative companies seeking to access public markets. Chapter 18A specifically governs the listing of pre-revenue biotech companies, while Chapter 19C facilitates secondary listings of qualifying issuers, particularly those with WVR structures.

CHAPTER 18A: REVOLUTIONISING BIOTECH ON HKEX

In April 2018, HKEX introduced Chapter 18A of its listing rules, which allows the listing of pre-revenue biotech companies that do not meet any of the financial eligibility tests of the Main Board. This initiative recognises the unique characteristics of biotech companies, whose value is largely driven by their R&D progress and intellectual property, rather than traditional financial metrics like revenue and profits. It created listing pathways for life-sciences and biotech companies that previously were precluded from the existing listing rules.

Under Chapter 18A, biotech companies can list on HKEX's Main Board provided they have a minimum expected market capitalisation of HK$1.5 billion (approximately US$191 million) at the time of listing.[56] They must also demonstrate that they are primarily engaged in R&D for the purposes of developing and commercialising innovative biotech products or processes.

The impact of Chapter 18A has been significant. Since 2018, 130 health-care companies have listed, raising a total of over HK$275 billion as of July 2024. Of these, 65 were pre-revenue biotechnology companies using the Chapter 18A listing pathway, raising over HK$120 billion (approximately US$15.3 billion).[57] This represents a remarkable achievement in just six years since the introduction of the new rules [58] and underscores how the rule change has unlocked HKEX's potential to become a major global funding hub for biotech and life-sciences companies.

The success of Chapter 18A has attracted a diverse range of investors, including specialist biotech funds, institutional investors and retail investors, creating a vibrant and liquid market for these companies. HKEX's total health-care market capitalisation tripled from around US$160 billion in 2018

to over US$550 billion in March 2021, accounting for 8 per cent of the total HKEX market capitalisation.[59] This growth has been driven in large part by the listing of pre-revenue biotech companies under Chapter 18A. The reforms have also had a positive impact on the broader health-care and biotech ecosystem in Hong Kong and mainland China, attracting talent, encouraging innovation and supporting the development of world-class R&D capabilities.

The impact of Chapter 18A demonstrates the potential for a well-designed listing framework to attract high-quality innovative companies and support the growth of the biotech sector. It also highlights the importance of recognising the unique characteristics and funding needs of pre-revenue companies, which may not fit the existing listing rules that focus on profit-based financial metrics.

CHAPTER 19C: ENABLING SECONDARY LISTINGS OF INNOVATIVE COMPANIES

In addition to biotech-specific reform, HKEX has also introduced Chapter 19C to facilitate the secondary listings of qualified overseas listed companies as well as qualified innovative companies with a WVR structure that are already primary listed on a qualifying exchange. These exchanges include the NYSE, Nasdaq and the LSE's Main Market Premium Listing segment.

Under Chapter 19C, Qualifying Issuers with a good compliance track record of at least two years on their primary exchange can secondary list in Hong Kong without having to fully comply with HKEX's listing rules. Instead, they can rely on their existing corporate structures and the regulatory regime of their primary market, subject to certain safeguards and disclosure

requirements.

The introduction of Chapter 19C has been successful in attracting high-quality companies to HKEX. There has been an increase in the number of "homecoming companies"[60] – firms, typically Chinese, previously listed on overseas exchanges and now seeking a presence in a market closer to their primary business operations – listing on HKEX. By 2021, 13 "homecoming" companies had secondary listed on HKEX under Chapter 19C, raising a total of HK$285.8 billion (approximately US$36.6 billion).[61] These companies have chosen to secondary list on HKEX to expand their investor base and tap into the liquidity of the Hong Kong market.

The success of HKEX's reforms is evident in the strong growth of its health-care and technology sectors in recent years. The Hang Seng Index, HKEX's benchmark index, now includes four health-care constituents, all of which were added after the introduction of Chapter 18A.

The reforms have also had a positive impact on the wider innovation ecosystem in Hong Kong and mainland China. The increased availability of capital for biotech and technology companies has encouraged more startups and entrepreneurs to pursue their ideas, knowing that they have a viable path to public markets. This, in turn, has attracted talent and investment into these sectors, creating a virtuous cycle of innovation and growth.

Recommendation 1: Close down AIM and create a rapid route to listing on the LSE Main Market with similar, but time-limited, tax and regulatory benefits.

The UK's public markets aren't working properly for high-growth companies. This is especially true of AIM, which has failed in its stated purpose of providing a home for scaling businesses. Efforts to create specific, high-growth exchanges in the LSE have also failed.[62]

Reform is needed. Rather than having a specific growth-company-focused market or segment that is separate from the main stock exchange – an arrangement that the more dynamic US economy does not have – AIM should be merged with the LSE's Main Market. The inheritance-tax exemption for existing shares of companies that are currently listed on AIM would continue for their current owners.

Reforms to the LSE Main Market are needed too, to ensure the UK has an exchange geared towards growing businesses in critical areas of the new economy. The UK has a world-renowned scientific research base, a vibrant startup ecosystem, and a strong track record of innovation in sectors such as AI, fintech and digital health. To accommodate these firms, the UK should have a special listing route onto the LSE Main Market specifically for high-growth firms in emerging technology sectors. By doing so, London can differentiate itself from other global exchanges and attract a pipeline of high-quality, innovative companies. Like in Hong Kong, the correct package of reform can revitalise the UK's capital markets, acting as a draw for companies in search of funding.

Shares that list via this route that are bought and sold during an initial period (for instance, the first five years after listing) should also be:

- Exempt from capital-gains tax, like shares that are currently invested in via the stocks and shares ISA wrapper.[63]
- Exempt from the 0.5 per cent stamp duty that is currently levied on share trades.[64]
- Exempt from inheritance-tax liability (similar to AIM shares).

This would create a favourable environment for investors in these companies: driving liquidity and encouraging investment.

This market-access route should be available for all firms that either:

- Qualify as scale-ups under the terms of the government's scale-up visa[65] (20 per cent revenue growth in the three preceding years and at least ten employees at the beginning of that period), or
- Have received funding through one of the UK's venture-capital tax schemes (such as the Enterprise Investment Scheme, Seed Enterprise Investment Scheme or Venture Capital Trust investment) in the five years before listing.[66]

This route to listing should be reliable and fast, so that all eligible firms regardless of sector can list within three months of beginning the process.

At the same time, firms should not be required to have three years of financial records, as is currently the case for the LSE Main Market. During this initial five-year period, continuing compliance requirements should be light touch. Disclosure requirements, for instance, should be narrowly defined. At the end of this period, companies that have listed on the Main Market via this route should revert to the same requirements as other listed companies.

Recommendation 2: Design the Private Intermittent Securities and Capital Exchange System (PISCES) to support pre-IPO companies.

The UK has announced its intention to create a new intermittent-trading venue on which companies could register to permit secondary-market share trading, such as employees selling shares awarded as part of their total compensation as opposed to primary trading, which are shares purchased directly from a company through share issuance.[67] To be successful, this exchange should be built to crowd in institutional investment from pre-IPO investors, for instance de-risking the shares on the platform by encouraging companies to give an indicative future IPO window.

Recommendation 3: Increase the competitiveness of the UK market for secondary listings of innovative companies by streamlining the process and improving their access to capital.

The LSE should explore reforms to facilitate secondary listings of international companies on its main market. Drawing on the success of the

Hong Kong Stock Exchange's Chapter 19C, the LSE should consider ways to streamline the process for secondary listings of innovative companies that are already listed on other major exchanges. This could involve:

- Providing automatic waivers from certain listing requirements, subject to minimum eligibility criteria and disclosure standards.
- Offering a more efficient process for secondary listings to attract international companies, especially UK companies currently listed in the US.
- Reforming rules to allow secondary listings to be included in indices on the main market.

By implementing these reforms, the LSE can attract companies seeking to tap into the UK's capital markets and expand their pound-based exposure. This approach could make a notable difference in enhancing the attractiveness and competitiveness of the UK's main market for international listings.

Recommendation 4: Reform the Corporate Governance Code to address the behaviour of proxy advisors.

As shown above, the ability of public UK companies to attract talented leadership is being hampered by the actions of proxy investors, which is itself a consequence of disproportionately high levels of foreign ownership.

Evidence suggests that proxy advisors' voting patterns are responsive to changes in the Corporate Governance Code.[68] Therefore, rather than attempt the Herculean task of rebuilding domestic ownership of the FTSE in the short term, the Financial Reporting Council should make targeted amendments to the Corporate Governance Code to encourage greater share awards to CEOs, in line with international best practice, and stronger benchmarking to international salary packages.

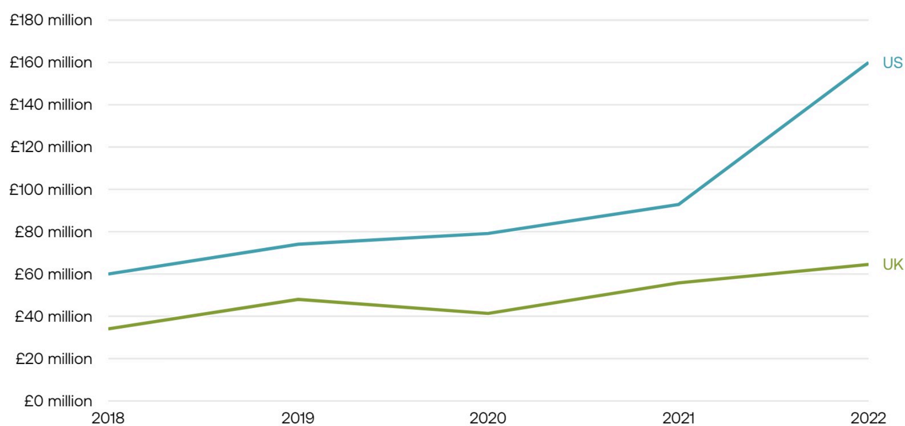
Recommendation 5: Create a "Growth Capital Fund" with £1 billion to support the establishment of five large-scale growth investors for science and technology firms.

To ensure that the UK has a strong pipeline of companies that could eventually IPO on its public markets, innovative companies must be able to grow to a size that makes going public a reasonable option. This means that there must be funding available for companies at more advanced fundraising stages, such as Series C and beyond, and experienced investors who can help companies grow to their full potential.

However, the UK does not have a developed set of large venture-capital funds capable of deploying capital at the scale needed for more mature pre-IPO companies. This can be seen in Figure 14, which shows that the average venture-capital fund in the US raises two to three times more than their UK equivalent.

FIGURE 14

The growing divide in venture-capital fundraising: US vs UK (2018–2022, mean fundraising per year)



Source: These data are compiled from the following reports: BVCA, Report on Investment Activity Series 2018–2022; NVCA Yearbook series 2018–2022.

The government should therefore support the creation of such funds. The

UK already supports the formation of venture capital through a range of programmes, most importantly the British Business Bank's Enterprise Capital Funds (ECF) programme,[69] which since 2006 has committed public money to venture-capital funds to address funding constraints faced by small and medium-sized enterprises. A 2021 review estimated that it was set to generate £2.80 in benefits for every £1 allocated to the programme.[70] However, the ECF programme is unsuitable for later-stage investment in innovative companies because it requires that venture-capital funds receiving public money commit to a maximum investment of only £5 million in each portfolio company.[71]

To address this gap and create a new generation of large-scale venture-capital funds capable of investing in later-stage funding rounds, the UK government should create a "Growth Capital Fund" with £1 billion of public funding.

This programme would invest £200 million directly in five different late-stage venture-capital funds, co-invested alongside at least twice as much private capital. The fund would leverage at least £2 billion of private capital and create five late-stage venture investors worth at least £600 million each. This is similar in principle to the British Business Bank's LIFTS programme, which invested £150 million of match-funded public money into a UK venture and growth fund.[72]

Recommendation 6: Scale up science and technology-focused equity analysts.

As described, the average AIM-listed company with a market capitalisation of £50 million to £500 million has four times fewer analysts assessing its performance and making investment recommendations than equivalent-sized firms on the US-based Russell 2000. The median AIM-listed company has no analyst coverage whatsoever. Low analyst coverage contributes to poor liquidity, high costs of raising money and low levels of investment.

To address this, the government should commit to being an "anchor buyer" of equity research in science and technology companies, subject to relevant minimum standards. Providing a guaranteed buyer would give firms a clear

incentive to expand their research coverage. To prevent misallocation, this could be limited, for instance, to reports on firms described in the sensitive technology sectors in the National Security and Investment Act, or firms that are eligible for the rapid listing route described in recommendation 1.

This could be modelled on other successful public-finance models that expanded market size by providing guaranteed prices, such as in the advance market commitment for Covid vaccines.

CASE STUDY

Advance Market Commitments

Advance market commitments (AMCs) are innovative financing mechanisms designed to incentivise the development and production of products or technologies that might otherwise lack a viable market. By guaranteeing future purchases at predetermined prices, AMCs create a financial incentive for companies to invest in the research, development and production of goods that serve important public needs.

In the context of Covid-19, AMCs played a crucial role in accelerating vaccine development and production. The US government's Operation Warp Speed, while not a traditional AMC, incorporated elements of market commitments by pledging billions of dollars for vaccine development and pre-purchasing doses. For instance, the US government committed $1.95 billion to Pfizer and BioNTech for 100 million doses of their Covid-19 vaccine, with the option to acquire 500 million additional doses.[73] This commitment, along with similar agreements with other pharmaceutical companies, helped create a robust market for Covid-19 vaccines and contributed to the unprecedented speed of vaccine development and distribution.

Another example of an AMC creating a new market is NASA's Commercial Orbital Transportation Services (COTS) programme. It functioned similarly by guaranteeing future purchases of space-transportation services. NASA committed $500 million in 2006 to incentivise private companies to develop cargo-transportation capabilities to the International Space Station.[74] This programme led to the emergence of commercial space companies like SpaceX and Orbital Sciences (now part of Northrop Grumman). The success of COTS paved the way for the Commercial Crew Program, which has now enabled private companies to transport astronauts to space. The initial

$500 million investment has resulted in a thriving commercial space industry, with SpaceX alone valued at over $100 billion, demonstrating the power of AMCs to create entirely new markets and industries.[75]

To assist with recruitment for equity analysts, the UK should use its extensive R&D infrastructure to bring financial-services firms to university campuses, such as via STEM-focused careers fairs for PhD candidates, or targeted relationship-building with specific academic departments.

This recruitment effort should include state-funded organisations such as the Catapult Network, whose sector-specific catapults include key areas of UK scientific advantage, such as advanced manufacturing, cell and gene therapy, and compound semiconductor applications.[76]

Recommendation 7: Reform the UK's regulatory environment for asset managers.

The UK's financial-services environment is characterised by high compliance costs and a low appetite for risk. This is the direct result of a significantly increasing and uncertain regulatory burden, which has damaged asset managers' margins without leading to better outcomes for investors.

To address this, the government and regulators should:

- **Conduct a full review of compliance costs experienced by active asset managers of different sizes.** Evidence suggests that costs of compliance – including AML regulations – are both expanding and eating significantly into revenues, especially for smaller firms. In numerous

interviews with asset managers, lawyers, brokers and others associated with the financial-services industry, different pieces of overlapping financial-services regulation, which have been described earlier, were named as increasing barriers to raising money and to adopting an active asset-management strategy. The government should undertake a review of the cost of compliance across the active asset-management sector with a view to establishing the actual costs borne by active investors and take steps to address them where they are disproportionate.

- **Publish the results of government-sponsored Senior Managers and Certification Regime reviews as quickly as possible.** In March last year the Treasury, the Prudential Regulatory Authority and the FCA opened a series of consultations into the Senior Managers and Certification Regime, which had been identified across a number of industry stakeholders as a burdensome process contributing to the compliance burden on asset managers. The government recognised these critiques, but it has been more than 12 months since these consultations were opened. To give the industry confidence, the government should announce and then implement plans for reform as quickly as possible.
- **Issue specific measurable outcomes or clear templates (depending on applicability) whenever UK financial regulators introduce an open-ended or flexible obligation on asset managers.** Many of the FCA's regulatory requirements are not prescriptive, but are instead intended to alter the process by which a targeted firm conducts its business. While nominally allowing for a degree of flexibility, this can lead to uncertainty in the firm itself as to whether they are or are not complying with the FCA's rulebook. As shown earlier with the FCA's 2019 open letter,[77] this can lead to damaging and unintended consequences. To guard against this, the UK's financial-services regulators should ensure that they issue specific, measurable outcomes when they create new open-ended obligations. For disclosure-based obligations, such as the Stewardship Code, regulators should issue template disclosure forms. This is so that firms can be confident in how to comply with their regulatory requirements, rather than adopt a belts and braces approach to foreclose against regulatory risk.

06

Conclusion

London's decline as a global financial centre is not inevitable. The reforms outlined in this report offer a clear path to revitalising the UK's capital markets and positioning London as the natural home for Europe's most promising tech companies.

By overhauling AIM, streamlining listings, deploying institutional capital strategically, expanding the number of equity analysts and cutting regulatory red tape, the UK can create an environment where innovative firms thrive and scale. These changes would not only stem the tide of companies leaving for foreign exchanges but also attract a new generation of high-growth businesses to list in London.

The choice between bold action and continued decline is clear. Britain's economic future hinges on transforming London into a powerhouse for innovative, high-growth companies. Implementing these reforms is not just an option – it is an economic imperative.

07

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Rhiannon Price, Barclays

Colin Rom, a16z

Martin Turner, BioIndustry Association

Martin Walton, Actimed Therapeutics

William Wright, New Financial

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