FOR START-UPS TO GROW AND SCALE IN THE UK WE NEED TO STIMULATE PUBLIC AND PRIVATE MARKETS

Author:
Lauren Crawley-Moore, Regional Lead, London & The South, UK Primary Markets, London Stock Exchange

At SETsquared's recent Investment Futures 24, I was invited to lead a roundtable on the investment landscape in the UK and EU compared with the US. It's a topic at the top of our agenda here at the London Stock Exchange, as well as with the broader financial market's community, regulators, and the UK Government.

In 2021, coming out of the pandemic, we had a record-breaking year for IPOs and globally, equity markets were very busy.

The last couple of years have seen a significant drop in capital raising globally, but the good news is we're starting to see some recovery. If you look at that recovery more broadly across global markets, on average, the UK is faring better. From 2021 to 2022, UK market volumes dropped by 71% but have grown by 17% from 2022 to 2023 (as of October). Global markets were down 58% from 2021 to 2022 and were down again another 19% coming into 2023.

> *"Undoubtedly, the last few years have presented a challenging funding environment. But if you look across the board, that's not just a UK or European problem. Unfortunately, the problem has been global – across the US and beyond."*
> **Lauren Crawley-Moore, London Stock Exchange**

What can we do to stimulate growth?

For public markets to perform well, we recognise that there needs to be a pipeline of private investment to fund companies at every stage of their growth. To support this, we're increasingly working on new initiatives in the private market space to offer companies further access to capital across the 'funding continuum'.

We've invested in a FinTech company, Floww, which helps companies raise from seed to series A investment. It's an online platform that connects scaling companies with venture capital and investors and has a structure to support businesses as they move through their funding rounds.

More recently, and this was mentioned in Chancellor Jeremy Hunt's speech at Mansion House in July last year, we've started developing an intermittent trading venue. At the moment, companies will reach a stage of growth where their only options can be to seek further investment, an early trade sale or perhaps an IPO, to provide an exit for existing shareholders. An intermittent trading venue will provide private companies an option to access a trading venue similar to a public company, where they can offer up their shares for trading, but on a on periodic basis, all whilst remaining a private company. It means that while they are not listing the business and they are not raising any capital like companies would in an IPO, they would be using a public market facility to be able to provide some liquidity to their shareholders on an intermittent basis. It's an evolution and crossover of the public and private markets that we hope to see launched in the next 18 months.

Jeremy Hunt's speech also spoke to UK pension investments in our private and public markets. There's no getting away from the fact that UK pension fund investment in UK equities has dramatically reduced over the last few decades, and we want to see more domestic capital into domestic businesses. There's a structural challenge there, but it's one that, through the work of the Capital Markets Industry Taskforce (CMIT), chaired by the London Stock Exchange's CEO, Julia Hoggett, is being widely discussed. The Mansion House Compact saw some of the UK's largest Defined Contribution pension providers, commit to allocating 5% of assets in their default funds to unlisted equities by 2030.

> *"We have so many exciting businesses here in the UK and encouraging retail participation in our markets, outside of our pensions, is important."*

To that end we have partnered with Primary Bid, an app that provides straightforward access, enabling the general public to buy shares in companies at IPO, on the same terms as institutional investors. Ensuring that everyone has access to markets is something we feel strongly about; it offers real benefit across all parts of the ecosystem, and we'd love to see more people investing in innovative start-ups and scale-ups.

At the London Stock Exchange, our job is to connect companies, creators, and entrepreneurs with capital, and these initiatives support that purpose. We know that the earlier we're talking to businesses the better they can be supported as they grow, gain capital and build a scalable business.

Regional ecosystems play a vital role

Regional ecosystems are vital to achieving this. Their strength, particularly in the Southwest, is vital to companies, enabling them to access the right support and investment at the right time. Some incredibly exciting companies are emerging from the SETsquared centres and programmes, demonstrating what can be done when you've got an ecosystem that supports those businesses. What's lovely about the Southwest is you see the growth companies coming back to talk and support the start-ups emerging on the scene. That interconnectivity is so important and something that the UK does well.

Putting a closer lens on UK vs US funding environment

Recently, there's been a lot of discussion about investment in the UK versus the US. There's no doubt that the US is a big market, providing companies with access to a large pool of predominantly domestic US capital.

What's interesting about the US market is that if we look at the main indices, they are dominated by a handful of mega cap stocks. So, their performance is dominated by a very small number of companies.

> *"If we look at growth company appetite in the UK versus the US, what we do well in the UK is supporting growth business, and we have a well-developed market and ecosystem that understands these companies."*

From a public markets perspective, the London Stock Exchange is home to AIM, which continues to be the most successful growth market in the world. We have companies coming to market much earlier than you would see in the US. For example, there is a great business that came out of the Midlands in 2022 called Aurrigo, which is in the autonomous vehicle space. It came to market at just £20m and raised £8m – its market cap is now a little over £40m. It was Innovate UK-backed, and it came through its regional ecosystem. If you took that business to the US, it would be too small for the public markets.

If you look at the performance of UK businesses that have gone to the US, which over the last ten years has been in the region of 23 companies raising $100m or more, all but four of them have shown negative share price performance and are currently worth less than at the point of their IPO.

The London Stock Exchange is the most international market in the world; one of the benefits of UK public markets is that you have access to a global range of investors. 50% of the investor base on our market is international capital, and 40% of that international capital is from the US. You don't need to list in the US to attract US investors; they're also here in London.

Whether a company has an international shareholder base, are employee owned or founder owned it is vital that they have access to the capital they need to succeed. We want to enable them to grow their businesses here, support the economy and create jobs. The UK market plays a role in that growth journey, not just through IPOs but through ongoing access to capital.

Throughout the UK, there's a strong focus on how we can support business better and how we can enable access to the right capital at the right time. I see that regionally through programmes like SETsquared and all the way through the regulatory reform agenda in public markets. Working together, we can seek to ensure that companies feel like there is increasingly more optionality and support and that they're able to better navigate through challenges as they grow.

Response from the investment community

"The UK and Europe have a thriving startup ecosystem, with a wealth of innovative companies and talented entrepreneurs. There is a significant amount of dry powder available for deployment through the introduction of Investment schemes like SEIS and EIS however, deployment stalls as investors tend to be more risk-averse when compared to their US counterparts, as they are often more critical in terms of valuation."

"Consequently, founders seeking to validate their higher valuations may be more inclined to seek funding in the US, where investors are generally more open to accepting higher valuations. This tendency can lead to some of the best companies moving further afield for investment, potentially impacting the long-term competitiveness and growth of the UK and European tech sectors."

"Nevertheless, the UK's Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS) as well as the European Venture Capital Fund (EuVECA) Regulation have played a crucial role in facilitating venture capital investment in the UK and EU. These schemes facilitate the accumulation and flow of capital to early-stage and high-growth companies allowing them to compete on an international basis."

Bernice Brooks,
Investment Analyst, Guinness Ventures

"At business angel level, we find that there is huge demand for pre-seed funding which is far in excess of the private funds available. We can receive around 100 applications in a month, but we only have capacity for between two to four due to Angel appetite and funds available."

"As a result, only a very small number of funding applications receive Angel investment. We see this as a clear issue as we're having to turn down a substantial amount of excellent companies."

"We have nearly 100 Angel investors members within Angel Investors Bristol and have a clear mandate to look at companies based in the South West and South Wales."

"I estimate that we'd need around 2,000 members to really support the local economy effectively."

"This leads us to conclude that there needs to be huge education piece around early stage investing in order to attract appropriate individuals who may have the potential to be investors."

"It's clear that the LSE is working hard to provide initiatives to allow early stage investors to find suitable exits. This should be commended but it must aligned to sharing knowledge to attract suitable investors in the first place."

"Our initial thoughts are to plan some educational pieces with regional accountants that have clients that may find the SEIS/EIS benefits attractive."

"Another challenge for Angel investing is sector knowledge. We will gravitate towards companies that we understand over others that we lack the confidence in. Where we have the opportunity to obtain trusted information which reassures us that a company has the potential to really grow in the market, we feel more inclined to invest. This may come from co-investing with a fund or group that has vertical industry knowledge, or via knowledge groups like SETsquared."

Peter Lockett,
Angel Investors Bristol

To catch-up on all the action from the Investment Futures 24 event, go to **SETsquared.co.uk/investment-futures-24**