



Blame game

With the UK's junior exchange hitting new lows for new listings, **Jon Moulton** takes a look at the issues it faces

Since its last 'peak' in September 2021, the AIM index is down nearly 50%. Add inflation and in real terms it would be down almost two thirds. Small caps are down globally, but the UK has been hit particularly hard. For comparison, The Russell 2000 Index – the US small caps index – is down 'just' 27% over the same period.

Price-earning multiples for UK stocks relative to international peers started to drift down after 2016's Brexit vote and declined further since the pandemic lockdowns. This UK discount cannot be attributed wholly to foreign investors turning away from the UK post-Brexit. Foreign investors actually remain the largest allocators to UK-listed companies generally.

So what else is driving AIM's underperformance? It is in a negative downward spiral of falling liquidity due to limited buyers and sellers, and consequently lower valuations. Smaller AIM stocks barely trade – often on a monthly basis and in tiny amounts. This leads to fewer new listings as companies look for alternative sources of funding, such as debt or private equity, that have been readily available and which will likely offer a more attractive exit route.

There have been just 12 new IPOs on AIM, but 59 companies have left AIM, in the 10 months to October 2023. Assuming IPOs continue on that same trajectory for the last two months of the year, 2023 will be the worst year for new issues since AIM's launch in 1995. AIM now has just 769 listed companies.

There were 1,694 listed AIM stocks in 2006, with new AIM IPOs peaking at 519 in 2005. AIM remains a noticeable market with an aggregate market cap of around £80bn. By way of comparison, that's the capitalisation of the 100th largest US stock or of the 10th largest UK stock on the Main Market. But for our investment banking and broking readers, the recent story is of declining volumes of transactions and the shrinkage of the AIM advisers' staff. Around 50 of the biggest current AIM stocks collectively make up half the market's total capitalisation. There are 52 stocks with a market capitalisation below £2m.

In a nutshell

What could turn sentiment around? Some would argue that heavy-duty regulation of listed companies proves unattractive to company owners. Public company regulation and governance is often clearly

disproportionately onerous for these smaller companies. Making much of this optional, rather than mandatory, would help. If investors want a mountain of information, then companies will doubtless comply – but many will not have to.

Investors chase success. The real problem, which is not just an AIM issue, is that poor returns from investing in smaller companies are dissuading further investors. This is a wider issue about growth and productivity in the UK economy – an issue beyond a simple solution. Low returns imply an excess of available capital – not a need for more.

Investing in the AIM Index has not been a great buy-and-hold strategy. If you invested £1 in AIM 10 years ago and reinvested all dividends back into the index, this would be worth just 95p today.

Otherwise, we are in the land of tax incentives. And AIM has lots – Enterprise Investment Scheme, Seed Enterprise Investment Scheme, inheritance tax, capital gains tax, stamp duty, loss relief, venture capital trusts, ISA eligibility, R&D tax credits – far too complex to cover in this piece. But it is an uncomfortable fact that despite all these subsidies, the AIM market has been failing over quite a long run.

On the whole, the political aim of these measures was to finance growth companies and/or to induce UK individuals to invest in this segment. In reality, AIM contains a real mix of companies – and most are not high growth. The largest trading sector on AIM is 'consumer discretionary'. Most of the larger growth company exit successes of recent years stayed private throughout their independent lives.

In his Mansion House Reforms this summer, Chancellor Jeremy Hunt announced a boost in investment in UK unlisted equities, with an agreement between nine of Britain's largest pension funds to invest 5% of their assets in UK start-ups by 2030.

This is how the government presented it, but the truth is that the institutions agreed to *allocate* 5% to unlisted equities, not necessarily UK or early stage at all. And allocation is not a concrete action. AIM stocks might not qualify. And will be under price pressure if they do.

But investor confidence will return at some price point. Value investors will appear. And when it turns, low liquidity could see prices soar. Without that scenario, AIM's very existence is threatened.

'The real problem is that poor returns from investing in smaller companies are dissuading investors'