The Future of the UK IPO

Jennifer Payne* and Clara Martins Pereira**

1. Introduction

The moment when a company decides to make its shares[1] available for sale and purchase on a trading venue for the first time is pivotal for any firm.[2] This process—known as 'going public'—gives investors in that company the possibility to trade their shares on public (secondary) markets. However, going public is not the right decision for every firm at every point in time. But if the 'whether' and the 'when' of going public have always been centrally important questions for companies, two other questions have recently joined them at the forefront: 'how' and 'where' should a company go public?

Historically, most companies go public through large equity-raising events known as 'initial public offers' (or 'IPOs'). Indeed, IPOs have often been understood as the typical culmination of successful growth—an almost inevitable step for any company after reaching a certain stage of development.[3] Typically, companies go public by listing their shares on national exchanges: usually in their home jurisdictions,[4] but often also in key markets such as the US or UK.[5]

More recently, however, three key trends have emerged to challenge these historical assumptions. First, it would seem that companies are taking increasingly longer to go public

[1]*Linklaters Professor of Corporate Finance Law, University of Oxford.

**Lecturer in Financial Law Education, King's College London.

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A company can also arrange for its debt securities to be traded on a public market, but the scope of this article is limited to equity securities.

[2] Miles Zheng, 'Direct Listing vs. IPO: The Anatomy of the Going-Public Market' (2020); Michelle Lowry, Roni Michaely and Ekaterina Volkova, 'Initial Public Offerings: A Synthesis of the Literature and Directions for Future Research' (2017) 11 Foundations and Trends in Finance 154.

[3] *See* Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3rd edition, Hart Publishing 2020). *See*, also, Lowry, Michaely and Volkova (n 2).

[4] Gerard Lyons, 'London's Global Reach and the Half a Trillion Dollars Equity Prize' (Institute of Economic Affairs - Brexit Unit, February 2018) <https://iea.org.uk/wp-content/uploads/2018/02/Londons-Global-Reach-and-the-Half-a-Trillion-dollars-equity-prize.pdf> accessed 12 December 2021.

[5] *See* Gullifer and Payne (n 3).

—or even foregoing that opportunity entirely, regardless of how much they have grown and how big they have become. Venture-backed private firms are increasingly likely to be acquired instead of exiting via an IPO,[6] and fast-growing companies display an increasing preference for raising capital in the private equity and debt markets.[7] Ultimately, more and more companies appear willing to remain private indefinitely—a phenomenon that is particularly prevalent among companies operating in the tech sector.[8]

This has been coupled with an increasing unwillingness of founding shareholders to give up control over the companies they launched. As such, even when companies do decide to go public, their founders might scour the global capital markets in search of jurisdictions where trading venues welcome firms deviating from 'one share, one vote' principles. In truth, cross-listing is nothing new—and companies have long cross-listed in jurisdictions with lower trading costs, greater liquidity, better price competitiveness, more robust rules, or added prestige—but the last few decades[9] have been notable for two reasons: first, because national exchanges have faced increasing competition from growing numbers of alternative (and often less regulated) trading venues;[10] and, second, because companies have begun to gravitate towards trading venues that welcome firms with dual-class share capital structures

[6] *See* James C Brau, Bill Francis and Ninon Kohers, 'The Choice of IPO versus Takeover: Empirical Evidence' (2003) 76 The Journal of Business 583.

[7] *See* Lowry, Michaely and Volkova (n 2).

[8] *See* Erik PM Vermeulen, 'New Metrics for Corporate Governance: Shifting Strategies in an Aging IPO Market', *The Oxford Handbook of Corporate Law and Governance* (Jeffrey N Gordon and Wolf-Georg Ringe, 2018), noting that 'the median time between the initial equity funding and the IPO in 2000 was approximately three years, compared with the seven years for companies pursuing an IPO in 2014.'

[9] The increasing popularity of dual class shares among tech companies, in particular, may have started in 2004, with Google's IPO (*see* Luca Enriques, 'The Hill Review and the Long and Winding Road to Premium-Listed Dual Class Share Companies' (*Oxford Business Law Blog*, 10 May 2021) <https://www.law.ox.ac.uk/business-law-blog/blog/2021/05/hill-review-and-long-and-winding-road-premium-listed-dual-class-share> accessed 12 December 2021).

[10] These alternative trading venues are typically referred to as multilateral trading facilities ('MTFs') in the UK and in the EU, and as alternative trading systems ('ATSs') in the US. As of December 2021, there were 142 MTFs registered with ESMA, 130 MTFs registered with the FCA, and 64 ATSs registered with the SEC. Naturally, many of these MTFs and ATSs belong to the same groups of companies.

(‘dual class listings’)[11]—and which, in practice, allow companies to slow down the pace at which they give up the benefits of private status.[12]

Finally, it would appear that companies looking to make their shares available for sale and purchase on public markets for the first time are increasingly interested in methods of going public that can fairly be described as alternatives to traditional IPOs. Some of these alternatives involve only slight re-formulations of the traditional IPO structure—with companies using Special Purpose Acquisition Companies (‘SPACs’) as vehicles for raising equity finance and eventually going public—but others represent more significant departures from the traditional IPO model—with firms seeking direct admission of their shares to listing in a public market without raising any finance at all (‘direct listings’).

These three trends have become particularly visible in a world shaped by the rise of tech unicorns, whose business models and expectations increasingly dictate the evolution of global capital markets.[13] For some, these three trends have also confirmed the long-foreseen death of the traditional IPO model:[14] indeed, while IPO activity was soaring in the 1990s and early 2000s,[15] the last two decades have generally witnessed a decrease in IPO numbers.[16]

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[11] This trend has been particularly visible in the US, but has been reaching a growing number of jurisdictions, sparking discussions of whether dual-class listings should be allowed in countries, like the UK, where institutional shareholders have been traditionally averse to deviations from voting equality principles (*see* Renee Adams and Daniel Ferreira, ‘One Share-One Vote: The Empirical Evidence’ (2008) 12 Review of Finance 51; Enriques (n 9)).

[12] *See* Vermeulen (n 8).

[13] The term ‘unicorn’ refers to a ‘venture-backed firm with a valuation in excess of $1 billion’ (*see* Badryah Alhusaini, Bradley E Hendricks and Wayne R Landsman, ‘Firm Categorization and IPO Price Formation: Evidence From Unicorns’ (2021)) and was first coined by Aileen Lee in 2013 (*see* Aileen Lee, ‘Welcome To The Unicorn Club: Learning From Billion-Dollar Startups’ (*TechCrunch*) <https://social.techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/> accessed 12 December 2021).

[14] Brian Cheffins, ‘Rumours of the Death of the American Public Company Are Greatly Exaggerated’ (2019) 44/2019 ECGI.

[15] Jay R Ritter and Ivo Welch, ‘A Review of IPO Activity, Pricing, and Allocations’ (2002) 57 The Journal of Finance 1795.

[16] *See* Vermeulen (n 8), noting, however, a ‘slight revival of the global IPO market starting in 2010.’ *See*, also, Lowry, Michaely and Volkova (n 2), referring to the evolution in the number of IPOs since 2000 as a ‘dramatic fall.’

But reports of the death of the IPO may have been exaggerated,[17] and globally there was a resurgence of IPO numbers in 2021,[18] perhaps reflecting a hope that the world is starting to return to relative post-Covid normality.[19] This might then be the perfect opportunity for countries to re-think how they support their public market and to look to the future of the IPO. At the same time, there is danger in reckless change, and countries should resist the urge to radically change IPO regulations in an attempt to ride the recent wave of post-Covid optimism and cater to the needs of companies in general, and tech-driven unicorns in particular. IPO regulation is a delicate balancing exercise, where the needs of companies for quick and easy access to the public markets must be weighed against the need to protect investors (and particularly retail investors) from being deceived into making ruinous financial decisions.[20] Even a small shift in this balance could have disastrous consequences for companies, investors—or both.

Having exited the EU on 31 December 2020—and freed itself from the need to follow EU regulations—the UK now has the opportunity to assess whether its rules still offer the right regulatory regime for IPOs. Indeed, self-reflection has already begun with the 2021 UK Listing Review (the Hill Review)[21] recommending significant changes to the UK regime which the Government subsequently confirmed its intention to take forward, and which have prompted a series of consultations on UK listing and prospectus reform.[22] Crucially, these have already resulted in changes to the UK regime.[23] This paper addresses the question of

[17] *See*, in regard to US markets, Cheffins (n 14).

[18] In Europe, for example, there were 287 IPOs (raising €55.4bn) in the first three quarters of 2021 alone—a number which has already surpassed the 135 IPOs (raising €20.3bn) of 2020 (*see* PwC, 'IPO Watch Europe 2020' (2020) <www.pwc.co.uk/ipowatch>; and PwC, 'IPO Watch Europe Q3 2021' (2021) <www.pwc.co.uk/ipowatch>).

[19] Indeed, it would appear that the variation in IPO numbers might be 'explained largely [if not exclusively] by fluctuations in companies' demand for capital and by changing investor sentiment' (*see* Lowry, Michaely and Volkova (n 2))—and it has been suggested that the recent increase in IPO numbers is being 'primarily driven by strong market conditions fuelled by post-pandemic optimism' (*see* PwC, 'IPO Watch Europe Q1 2021' (2021) <www.pwc.co.uk/ipowatch>).

[20] Notably, the goal of IPO regulation is not to protect investors from losses, but to allow them to make informed decisions that may reflect an efficient allocation of resources (*see* Gullifer and Payne (n 3)).

[21] UK Listing Review, 3 March 2021 chaired by Lord Hill (the 'Hill Review').

[22] *See* HM Treasury, UK Prospectus Regime Review- A Consultation, July 2021 ('UK Prospectus Regime Review'); HM Treasury, Wholesale Markets Review, Consultation, July 2021.

[23] *See* FCA, Investment protection measures for SPACs: Changes to the Listing Rules, PS21/10, July 2021; FCA, Primary Market Effectiveness Review: Feedback and final changes to the Listing Rules, PS21/22, December 2021.

what the right balance for the UK IPO market might be. First, it analyses how the traditional IPO model has evolved. Second, it places the UK IPO market in its wider context and discusses the development of other investment models and the extent to which they might be impinging on the traditional IPO model. Finally, it discusses what the UK can learn from these new developments and what regulatory action would have been required with a view to revitalising the UK IPO and getting the balance right for its companies and investors.

The changes to the UK prospectus and listing regime are still ongoing, so their full extent will only become clear in the fullness of time. This paper assesses the changes to date and considers the direction of travel. Ultimately, it is argued that the changes to date do not go as far as they could have, and they stay largely within the framework of the current regime rather than undertaking any meaningful changes to the regime itself. While change for its own sake is not helpful and some caution is advisable, it seems unlikely that these reforms will do much to secure the UK's place in the global IPO market.

2. UK IPOs today

2.1 Going public through an IPO

The choice to go public is one of the most impactful decisions that a company can make in its lifetime, but it is also a decision that many companies resist, postpone, or avoid. This is because going public comes with significant challenges and risks for companies and investors alike.

First, companies choosing to make their shares available for sale and purchase on public markets for the first time inevitably undertake a process that is both costly and time-consuming—depending also on the complexity and degree of regulation of the specific method through which they eventually elect to go public. Upon going public, companies also become subject to substantial additional regulation—depending now on the exact markets where they ultimately choose to list.[24] Naturally, these rules are meant to protect investors

[24] In the UK, this added regulatory burden includes the FCA's Prospectus Regulation Rules, Listing Rules, and Disclosure Guidance and Transparency Rules (for a company wishing to list with the Main Market of the London Stock Exchange), as well as the LSE's AIM Rules for Companies (for a company wishing to list with the Alternative Investment Market of the London Stock Exchange)—and may also include a number of 'comply-or-explain'-type corporate governance principles and provisions (*see* the rules in the UK Corporate Governance Code 2018, applicable to all companies with a Premium Listing of equity shares in the UK). Additionally, it is worth noting that a private company that wants to offer its shares to the public must first become a public

who are willing to fund companies about which they may actually know very little;[25] however, the added regulatory burden imposed on publicly-traded companies can also act as a barrier to the financing of and investment in small and medium enterprises ('SMEs') that are unable to cope with the significant costs of going public.

At the same time, going public also carries several important benefits for shareholders—including both retail and sophisticated investors. Importantly, going public allows a company to provide an exit route for its current (and future) shareholders. Typically, investors in private companies must find a private buyer for their shares before they can realise their investment,[26] but investors in public companies enjoy a ready market for their shares—the very existence of which causes a rise in the value of such shares, reflecting both their increased liquidity and their increased usefulness as collateral.[27] This also helps shareholders in publicly-traded companies to diversify their holdings,[28] as well as to invest in more companies without having to get involved in their management.[29]

But it is not just shareholders who stand to benefit from a company's decision to go public: companies themselves can gain significantly from having their shares freely traded on public markets. Most obviously, companies that go public by issuing new shares to the public for the first time gains access to new sources of equity finance from a wider range of investors—which might be particularly valuable at times when companies' industries are over-valued.[30] Additionally, public companies can use their (publicly-traded) shares as a form of

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company—and public companies are subject to minimum share capital requirements (*see* s 763(1)(a), Companies Act 2006), a more onerous legal capital regime (*see* Part 17, Companies Act 2006), as well as various other additional administrative requirements.

[25] As noted previously, the goal here is not to protect investors from losses, but to ensure that they are able to make informed decisions (*see* fn 20).

[26] Alternatively, investors in private companies might be able to exit their company if they hold redeemable shares, if the company offers to repurchase their shares, or if the company is wound up (*see* Gullifer and Payne (n 3)).

[27] Most shares must be made freely transferable before they can be admitted to listing or trading on a public market. In the UK, *see*, for example, FCA Handbook LR 2.2.4(1) and AIM Rules for Companies, 1 January 2021, 32.

[28] *See* Lowry, Michaely and Volkova (n 2).

[29] This is generally true for any limited liability company. For an in-depth discussion of the advantages of limited liability for investors, *see* Frank Easterbrook and Daniel Fischel, 'Limited Liability and the Corporation' (1985) 52 University of Chicago Law Review.

[30] Marco Pagano, Fabio Panetta and Luigi Zingales, 'Why Do Companies Go Public? An Empirical Analysis' (1998) 53 The Journal of Finance 27.

payment, or in employee remuneration packages that include shares or stock options.[31] Indeed, it has been historically suggested that key motivations for going public include not just providing for future investment needs[32]—but also facilitating future share-for-share acquisitions.[33] Finally, going public is generally coupled with corporate governance improvements,[34] which often come coupled with significant gains in credibility and prestige[35] —not least because of the publicity inherent in most going public processes.[36]

Ultimately, these considerations illuminate the fact that not every company should go public. Most importantly, they make it clear that the decisions of 'whether,' 'when,' 'how' and 'where' to go public are crucially important for any company looking to have its shares traded in public markets. As such, countries and jurisdictions looking to encourage the development of a healthy public market must endeavour to create an environment that provides effective answers to the changing needs of modern companies, while also protecting any investors interested in financing those companies.

It is widely acknowledged that the UK has traditionally been able to provide an attractive environment for companies looking to go public,[37] but the desirability of the UK public markets has been recently brought into question.[38] At the centre of the discussion lies the IPO: the process by which a company makes a public offering of its shares for the first time,[39]

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[31] *See* Lowry, Michaely and Volkova (n 2), noting the importance of the public market's price-forming mechanisms for valuing stock options attributed to owners and employees.

[32] Pagano, Panetta and Zingales (n 30).

[33] James C Brau and Stanley E Fawcett, 'Initial Public Offerings: An Analysis of Theory and Practice' (2006) 61 Journal of Finance 399.

[34] These positive corporate governance changes can be forced upon companies as a result of their newly-acquired status as a public company. In the UK, for example, public companies are subject to slightly more demanding capital raising and maintenance rules; they might also fall under the scope of the UK Corporate Governance Code 2018, which applies to (public companies) with a Premium Listing of equity shares in the UK. Additional corporate governance improvements might also be encouraged by the fact that the shares of a public company are priced by the public markets where they are traded, by the fact that public companies are more likely to be followed by analysts, or by the fact that the shares of publicly-traded companies can be used in equity-based compensation schemes (which can arguably play a valuable corporate governance role). For a discussion, *see* Gullifer and Payne (n 3).

[35] *See*, in regard to the US, Lowry, Michaely and Volkova (n 2).

[36] ibid.

[37] *See*, ia, Gullifer and Payne (n 3).

[38] *See* Hill Review, 33.

[39] Paul Davies, Sarah Worthington and Chris Hare, *Gower: Principles of Modern Company Law* (11th edition, Sweet & Maxwell 2021).

usually by issuing new shares in the primary[40] market[41] (which are then typically admitted to trading in secondary public markets). Unlike other methods of going public,[42] IPOs allow companies to raise new funds that enter the company as new capital. This increased access to equity finance is especially important for companies wishing to expand their business beyond the financing ability of their initial shareholders—and might explain why the IPO has been historically seen as 'a natural progression over the firm's life cycle.'[43]

Naturally, this financing function can also be performed by private markets, or by the issuing of debt securities, but IPOs uniquely combine access to equity finance with the many benefits that have been traditionally associated with going public. Yet, the last couple of decades have seen a generalised decline in IPO numbers—and although there has been a resurgence of IPO numbers in some jurisdictions in recent years, it appears that this revival is being built on the back of methods for going public that represent more or less significant departures from the traditional IPO model.

2.2 The fall of the traditional IPO model

The decision to go public raises many questions, but the 'how' used to have a fairly straightforward answer: the IPO. Historically, most companies have been going public by offering their securities to the public via an offer for sale or subscription of those shares, usually accompanied by the listing of those shares on one or more trading venues.

Regardless of its historical popularity—or perhaps (at least partly) because of it—the IPO is heavily regulated in most jurisdictions. In the UK, the IPO is primarily regulated through mandatory disclosure rules, but also through rules that require the country's conduct regulator, the Financial Conduct Authority ('FCA'), to screen companies wishing to go public. Finally, there are also rules that govern the behaviour of companies after they go public.

[40] There are arguably three different types of primary markets: the IPO market, captive markets where financial institutions place securities with their clients, and fringe direct offering markets. For a discussion, *see* John Armour, *Principles of Financial Regulation* (Oxford University Press 2016).

[41] *See* Gullifer and Payne (n 3).

[42] Typically, companies go public by offering their securities to the public for the first time—which they can do either through an offer for sale or subscription, or by means of a placing. Alternatively, companies can just make their shares available for sale and purchase on public markets via an 'introduction' or 'direct listing.' For a discussion of the different methods for going public, *see* ibid.

[43] *See* Lowry, Michaely and Volkova (n 2).

Importantly, companies looking to offer their securities to the public[44] are usually required to publish a prospectus,[45] although recent regulatory reform has sought to alleviate the impact of this requirement: by decreasing the standard of disclosure for certain issuers,[46] by facilitating the use of pre-approved registration documents,[47] and by extending the circumstances that exempt companies from the requirement to publish a prospectus.[48]

Despite this historical popularity, global IPO numbers have been declining for the past two decades, never really soaring to the heights seen in the late 1990s and early 2000s,[49] at least when it comes to more traditional IPOs.[50] Specifically in the UK, IPO numbers fell significantly between 1999 and 2011, and particularly after the global financial crisis of 2007-2008.[51] The following decade witnessed a further decline in IPO numbers as the annual average of 150.5 listings recorded between 2000-2009 was followed by an annual average of 82.2 listings between 2010-2019.[52] And even though the UK has historically enjoyed significant popularity as a cross-listing destination,[53] London accounted for only 5% of all

[44] The FCA Handbook defines offers to the public as any 'communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe for those securities,' with the definition also applying to the 'placing of securities through financial intermediaries' (*see* FCA Handbook, Glossary available at <www.handbook.fca.org.uk>).

[45] *See* PRR 1.2.1.

[46] Indeed, there are a number of issuers—namely SMEs—who can choose to draw up a less demanding UK Growth Prospectus under article 15 of PRR 2.6.

[47] *See* PPR 2.4, which facilitates access to public markets by issuers who have published universal registration documents two years in a row.

[48] Notably, offers addressed only to 'qualified investors' are exempt from the requirement to publish a prospectus (*see* PRR 1.2.3(4)(a))—as are offers addressed to fewer than 150 natural or legal persons in the UK, other than qualified investors (*see* PRR 1.2.3(4)(b)), offers of securities whose denomination per unit amounts to at least € 100,000 (*see* PRR 1.2.3(4)(c)), offers of securities addressed to investors who acquire securities for a total consideration of at least € 100,000 per investor, for each separate offer (*see* PRR 1.2.3(4)(d)) and offers of securities with a total consideration in the UK of less than € 8,000,000, calculated over a period of 12 months (*see* FCA Handbook, P.R. 1.2).

[49] *See* Ritter and Welch (n 15).

[50] Alternatives to traditional IPOs have been faring differently, as discussed below in section 3.

[51] 'The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report' (2012) ('Kay Review').

[52] Gbenga Ibikunle, Alina Khakimova and Khaladdin Rzayev, 'Factors Influencing the Decline in the Number of Public Companies in the UK' <https://www.research.ed.ac.uk/en/publications/factors-influencing-the-decline-in-the-number-of-public-companies> accessed 12 December 2021.

[53] *See* Hill Review, 1.

IPOs between 2015-2020[54]—and 4% of global IPO proceeds raised in the third quarter of 2021.[55]

Macro-economic factors like business cycles, volatility and interest rates all have significant explanatory power when it comes to fluctuations in IPO numbers,[56] but it is worth considering three other explanations for the decline of the traditional IPO model. First, the decline in IPO numbers may be explained by a decrease in the number of SMEs going public[57]—which has been linked to the increased tendency of private companies selling to larger firms instead of going public,[58] as well as to the increased availability of capital to private firms.[59] This tendency is particularly pronounced in companies with difficult-to-value intangible assets, as is often the case with tech companies.[60] Second, the decline in the numbers of traditional IPOs may be explained by growing IPO regulation, and this of course can also interact with the first explanation by encouraging firms to pursue alternative options with a lower regulatory burden, such as that offered by private equity. Despite recent attempts to ease the burden that falls on companies going public through IPOs, most jurisdictions still have fairly burdensome IPO rules in place as well as significant regulatory burdens in the secondary market.[61] Third, it is possible that decreases in IPO numbers in a particular country, such as the UK, might be the product of increased competition amongst trading venues and jurisdictions in the modern fragmented global capital markets on the basis of price or other benefits. As cross-listings become easier and more popular—and listing options more abundant—certain countries may witness a decline in their public markets.[62]

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[54] ibid.

[55] *See* PwC, 'IPO Watch Europe Q3 2021' (n 18).

[56] Eliana Angelini and Matteo Foglia, 'The Relationship Between IPO and Macroeconomics Factors: An Empirical Analysis from UK Market' (2018) 19 Annals of Economics and Finance 319.

[57] Xiaohui Gao, Jay R Ritter and Zhongyan Zhu, 'Where Have All the IPOs Gone?' (2013) 48 Journal of Financial and Quantitative Analysis 1663.

[58] *See* Brau and Fawcett (n 33); and Gao, Ritter and Zhu (n 57).

[59] For a summary of the most relevant literature, *see* Lowry, Michaely and Volkova (n 2).

[60] Ibikunle, Khakimova and Rzayev (n 52).

[61] The evidence is mixed, but Ritter suggests that 'regulatory burdens undoubtedly account for some of the decline' in US IPO numbers after the 'technology bubble burst in 2000' (*see* Jay R Ritter, 'Equilibrium in the Initial Public Offerings Market' (2011) 3 Annual Review of Financial Economics 347).

[62] Craig Doidge, G Andrew Karolyi and René M Stulz, 'The U.S. Left behind? Financial Globalization and the Rise of IPOs Outside the U.S.' (2013) 110 Journal of Financial Economics 546.

Ultimately, these explanations illustrate one important fact: while variations in IPO numbers are partially explained by macro-economic factors, they are also shaped by companies' appetite for alternatives that allow them to stay private longer, or—if their option is to go public—to retain some of the benefits of private ownership, or to evade some of the regulatory costs inherent in traditional IPO models.

When it comes to reviewing the various proposals, consultations and reforms that have flowed from the Hill Review, it is clear that two of these three concerns have played a significant role in shaping the Government's prospectus reform proposals and the changes made by the FCA to its Listing Rules, namely a concern to alleviate the regulatory burden and a desire to address regulatory competition issues.

The goal of reducing the regulation burden is central to the Government's prospectus reform proposals, although a significant part of this comes from a desire to 'remove duplication'.[63] One of the central proposals arises from a recognition that the current regime brings together two different regulatory concerns – the regulation of public offers of securities, and the regulation of admissions to stock markets – and accordingly that these should be dealt with separately so that they can be addressed on their individual merits. The proposals therefore retain the prohibition on the public offer of securities without a prospectus, but include a number of additional exemptions from the need to publish a prospectus for companies offering transferable securities in the UK, including an exemption for companies with securities admitted to trading on various stock markets and for issuances to existing securityholders.[64] In parallel, it is proposed to remove the current prohibition to trading on a UK regulated market without first having published a prospectus,[65] and instead to allow the FCA to incorporate a replacement regime in its handbook so that the FCA is able to decide when a prospectus is needed. The intention is that giving the FCA an enhanced remit and empowering it to make changes where it deems necessary by moving a number of matters to the FCA handbook, such as the admission to trading regime, will also make the regulation of prospectuses more agile and dynamic. This

[63] UK Prospectus Regime Review n 22, 6.

[64] Ibid, ch 7. There are also new provisions regarding MTFs (such as AIM), see ch 6.

[65] FSMA, s 85(2).

stands in contrast to the existing regime which is inherited from EU law and has resulted in much of the detail being included in primary legislation.[66]

Similarly, the changes recently introduced by the FCA to its Listing Rules 'aim to reduce barriers to companies listing in the UK and encourage private companies to consider listing at an earlier stage,' ultimately enhancing the attractiveness of UK markets.[67] With that in mind, the new FCA Listing Rules no longer contain a presumption that listing is suspended upon announcement of a potential acquisition target (or when details of the proposed acquisition have leaked) for SPACs that meet certain criteria.[68] Additionally, recent changes to these rules allow a targeted form of dual class shares structures within the premium listing segment of the market, reduce the level of shares required to be in public hands at listing from 25% to 10%, and increase the minimum market capitalisation threshold for both the premium and standard listing segments for shares in companies other than funds to £30 million.[69]

Significantly, these reforms do not really address one of the principal aspects of regulatory burden, namely the sheer volume of mandatory disclosure required in an IPO. One of the criticisms of the current regime raised by respondents to Lord Hill's consultation was the ever-growing size of prospectuses without apparent utility for the reader of the document. While the Government proposes that the FCA's extended remit include specifying detailed rules on prospectus content,[70] there is little or no detail on this in the consultation itself. Indeed, the only substantive change included in the Government's planned reforms is to encourage issuers to include forward-looking information in prospectuses by reducing the liability standard for such information from a negligence standard to a recklessness or

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[66] It is proposed that certain provisions, such as the rules regarding liability for a prospectus (FSMA, s 90) should remain in primary legislation.

[67] FCA, Primary Market Effectiveness Review: Feedback and final changes to the Listing Rules, PS 21/22, December 2021, 5.

[68] FCA, Investor protection measures for special purpose acquisition companies: Changes to the Listing Rules, PS 21/10, July 2021.

[69] The changes recently proposed to the FCA Rulebook also include additional minor modernisations of its Listing Rules, Disclosure Guidance and Transparency Rules, and Prospectus Regulation Rules.

[70] The Government proposes to retain the overall standard of preparation for the Prospectus as the current 'necessary information' test (see Art 6(1) of the UK Prospectus Regulation): The UK Prospectus Regime Review n 22, ch 4.

dishonesty standard.[71] A stated goal of the Government's reforms is to improve the quality of the information that investors receive, but there is no serious discussion of the volume of information or the overall utility of the mandatory disclosure model. While these changes are intended as a fundamental overhaul of the regime, they are in many ways quite conservative.

Other aspects of the proposed changes to the prospectus regime seek to address the attractiveness of the UK in this context. One of the objectives is therefore to create a framework that facilitates overseas companies making or extending a public offer into the UK.[72] Indeed, the changes to FCA rules regarding SPACs and dual class shares (and discussed further in part 3.2) can be viewed in this light, although again they appear to be modest.

By contrast, the proposed reforms give little attention to the other reason for the decline in IPO numbers described above, namely the rise in attractive alternative capital-raising options available to companies. The proposed changes do not fully account for the challenges and opportunities provided by the alternatives to the traditional IPO model that have developed in recent years. The consequence of this, discussed in part 3 below, is that it is unlikely that the reformed IPO model envisaged by these changes will provide a meaningful alternative to these mechanisms in practice.

3. The development of alternatives to the IPO

Although historically companies in need of equity capital had few alternatives, in recent years their options have increased substantially. These fall into two broad categories: first, the private market has grown enormously with the development of venture capital and private equity and the advent of crowdfunding. These options have become particularly attractive (and are sometimes the only alternative) for SMEs and early-stage companies, though the private equity market has grown to the point where it can also encompass the purchase of FTSE 100 companies such as Alliance Boots, which was purchased by KKR in 2007. Private equity can operate as a genuine alternative to an IPO, so that companies may delay their entry onto the public market, or may even forego this option altogether. However, not all of these capital raising mechanisms operate in this way; equity

[71] Ibid, ch 5.

[72] Ibid, ch 8.

crowdfunding in the UK at present involves far smaller and earlier stage companies raising much smaller sums of money than those contemplating IPOs. The second category involves a series of recent developments that are intended to facilitate access to the public markets. Some of these, such as SPACs and direct listings, are (more or less significant) adjustments to the existing IPO model as a way of tackling concerns about the costs and time required in a traditional IPO, while others, such as dual class shares, are intended to incentivise founders to make use of the IPO structure. The growth of both categories raises questions about the role of the IPO, its value for companies and investors, and the nature of its regulatory regime.

The development of both of these categories responds to the cost and regulatory burden of the traditional IPO model, particularly the costly regime of mandatory disclosure that is at the heart of IPO regulation. It is worth remembering the purpose of this regulatory burden however: the mandatory disclosure regime is intended to protect investors, particularly retail investors, and to enable them to make informed choices, culminating in efficient resource allocation decisions. Without this protection the concern is that issuers will use their informational advantage to sell overvalued shares; in the absence of regulation sophisticated investors could demand a lower price to compensate them for this risk, leading to an increase in the cost of capital for issuers. This model has some downsides of course, particularly for SMEs unable to bear the cost of the regulatory burden, or early-stage companies unable to comply with the disclosure requirements. Investors also lose the opportunity to invest in these companies, and in particular miss the chance to participate in the early-stage gains that some of these companies, particularly the tech unicorns, make. There are trade-offs here. Reducing the regulatory burden might allow more SMEs to offer their shares to the public, but that is likely to be at the expense of investor protection. Any regulatory model needs to balance these competing goals.

3.1 The development of the private market

3.1.1. Private Equity

One of the alternatives that has come to the fore over the last 30 years is private equity. This enables companies seeking an injection of capital to receive this from a private equity firm rather than from the public markets—and often obtain a better price than they would

by selling their shares in an IPO. Private equity has grown enormously to the point where it is said to rival the public markets as a source of financing.[73] In 2019, for example, members of the British Venture Capital Association (BVCA) invested £22.3 bn into 1530 companies.[74] The term 'private equity' can encompass a wide variety of transactions, from seed capital and venture capital which focuses on young and emerging companies, to the provision of finance (generally via the acquisition of a majority stake) to mature firms. It is this latter form of private equity that is the most direct alternative to the public markets. This might involve the purchase of public companies which are then taken private, or the injection of capital into a mature private company as an alternative to an IPO.[75]

As in an IPO, private equity can enable existing shareholders to exit and realise their gains, and can facilitate an injection of capital to fund the company on the next stage of its growth, all without the regulatory burden or the inherent uncertainty of the IPO process. Private equity also has some unique benefits for companies and investors as compared to the IPO model. There is a close alignment between directors and shareholders, given that the only shareholders in a private equity backed company will be the directors and the private equity fund, with the latter sometimes taking a majority stake, and therefore gaining the ability to remove directors, and at other times taking a minority stake and achieving much the same position via contractual rights in the shareholders' agreement. The number of shareholders is therefore tiny, compared to a publicly traded company, with a majority shareholder that is well-informed and powerful, and directors that have significant skin in the game. The board is small and specialised compared to a typical publicly traded company, comprising just the shareholder-directors, and a small number of experts appointed by the private equity fund. The boards of private equity companies tend to meet more frequently than those of publicly traded companies and are unburdened by the slew of ongoing disclosure obligations and corporate governance obligations that affect publicly traded companies.[76]

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[73] M Jensen, 'The Eclipse of the Public Corporation' Harvard Business Review (Sept-Oct 1989); B Cheffins, 'Rumours of the Death of the American Public Company are Greatly Exaggerated' ECGI Working Paper No 444/2019.

[74] BVCA, *Report on Investment Activity 2019*.

[75] An IPO may be used as an exit strategy for a private equity fund, as a way of realising their gains at the end of the investment period.

[76] VV Archarya, M Hahn and C Kehoe, 'Corporate Governance and Value Creation: Evidence from Private Equity' (2016) 26 Review of Financial Studies 2387. Although there has been an increase in the level of disclosure obligations affecting private equity in recent years (see Guidelines Monitoring Group, Guidelines for

The reduced administrative burdens for private equity backed companies compared to publicly traded companies is also a significant benefit. From the investors' perspective, private equity can lead to superior returns, although, unlike the public markets, a private equity investment has traditionally been more illiquid and locked-in (although secondary markets continue to develop to counteract this), with private equity funds typically raised with an expected life of around ten years. In Paul Myners' report for the Treasury in 2001 on institutional investment, including the private equity industry, he noted that the net returns per annum to investors in UK-managed private equity funds raised between 1980 and 1995 outperformed public equity market comparators over one-, three-, five- and ten-year periods and that over the ten-year period to 2001 private equity as a whole outperformed UK equities as an investment class.[77] However, these numbers mask wide variations between the performances of different funds. The sources of these gains have been variously ascribed to the alignment of shareholders and directors resulting from the ownership model, the high levels of leverage in portfolio companies, the reduction of the regulatory burden on such companies, and the ability of private equity funds to spot undervalued companies in which to invest.[78]

This has prompted questions as to whether the public markets should seek to emulate these beneficial features, such as the reduced regulatory burden, in order to secure similarly improved gains for investors. This is not straightforward, however. Setting aside the difficult issue of whether lower burdens will lead to greater returns, the purpose of regulation as between the two is quite distinct. For IPOs, the predominant regulatory rationale is to

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Disclosure and Transparency in Private Equity, 2014 and Alternative Investment Fund Manager Regulations 2013) the administrative burden is still far less than exists for publicly traded companies.

[77] HM Treasury, Myners Review of Institutional Investment in the UK (2001), para 12.50. There is a significant literature on whether superior returns do actually result, see e.g.: L Phallipou and O Gottschalg, 'The Performance of Private Equity Funds' (2009) 22(4) *Review of Financial Studies* 1747; SN Kaplan and A Schoar, 'Private Equity Performance: Returns, Persistence, and Capital Flows' (2005) 60(4) *Journal of Finance* 1791; F Lopez-de-Silanes, L Phallipou and O Gottschalg, 'Giants at the Gate: Investment Returns and Diseconomies of Scale in Private Equity' (2015) 50(3*) Journal of Financial and Quantitative Analysis* 377: RS Harris, T Jenkinson and SN Kaplan, 'Private Equity Performance: What Do We Know?' (2013) 69(5) *Journal of Finance* 1851; R Braun, T Jenkinson and I Stoff, 'How persistent is private equity performance? Evidence from deal-level data' (2017) 123(2) *Journal of Financial Economics* 273. In terms of the performance of funds of funds (a form of financial intermediation in private equity) see R S Harris, T Jenkinson, S N Kaplan and R Stucke, 'Financial intermediation in private equity: How well do funds of funds perform?' (2018) 129(2) *Journal of Financial Economics* 287.

[78] See eg L Renneboog, T Simons and M Wright, 'Why do public firms go private in the UK? The impact of private equity investors, incentive realignment and undervaluation' (2007) 13 Journal of Corporate Finance 591.

provide investors (including unsophisticated retail investors) with the disclosure needed to decide whether to invest. By contrast there are often no retail investors in the private equity model. The investors in private equity are predominantly a mixture of institutional investors, sovereign wealth funds and high net worth individuals, who are assumed to be largely able to bargain for their own protection. Retail investors cannot typically invest into this asset class; usually, the closest they can come is an indirect investment, namely if the private equity firm is listed on a publicly traded market, or second-hand if their pension fund (for example) invests in private equity. The regulatory focus for private equity lies elsewhere, with concerns about transparency in the context of other stakeholders, such as employees and the public at large, and in systemic risk concerns.[79] Changing the approach to private equity and enabling retail investors to invest directly would necessitate a reconsideration of the light regulatory approach that exists at present, which would in turn undermine many of the current benefits of the private equity model.

3.1.2 Equity crowdfunding

A more recent innovation as a source of equity capital for companies is crowdfunding. This comes in many forms, not all of which involve investors investing in a company with a hope of a return.[80] The sums raised are significant: $304 bn was raised globally in 2018.[81] The geographical split is very uneven, however: China had 70% of the market share in 2018, the US had 20%, and the UK just 3.5 %. Within these number there is also a significant skewing towards peer-to-peer lending, involving loans to companies organised via an online platform, with equity crowdfunding, whereby investors can invest in the securities of a company via an online platform, accounting for a relatively small proportion of the money raised.[82]

[79] See J Payne, 'Private Equity and Its Regulation in Europe' (2011) European Business Organization Law Review 559; E. Ferran, 'After the Crisis: The Regulation of Hedge funds and Private Equity in the EU' (2011) EBOR 379.

[80] For example, in donation crowdfunding, people invest simply because they believe in the cause, and may receive some return (such as tickets to an event), but may not; reward crowdfunding often involves some kind of non-financial reward.

[81] See Cambridge Centre for Alternative Finance (CCAF), Benchmarking Report, April 2020. This figure represents money raised and doesn't take account of platform fees or other expenses.

[82]According to the CCAF Benchmarking Report 2020, equity based crowdfunding accounts for just 0.5% of the funds raised.

Equity crowdfunding is in some ways similar to an IPO in that it can enable a company to receive equity financing from the public.[83] Unlike IPOs the company in question need not be a public company, and indeed equity crowdfunding is most commonly used by very small and early-stage companies. In this way equity crowdfunding also stands in contrast to many of companies making use of private equity financing. Equity crowdfunding addresses the financing needs of a very different sector of the economy. One of the challenges of the IPO model is that the significant regulatory burden attached to it, particularly the mandatory disclosure regime that aims to protect retail investors, makes it inaccessible for smaller companies. Recent reforms have aimed to address this issue, creating a reduced prospectus regime for SMEs,[84] but the reductions are relatively slight, and fail to address the needs of micro-enterprises of the kind that make use of equity crowdfunding. Equity crowdfunding makes use of the €8 million exemption to avoid the need to publish a prospectus,[85] so that issuances over that size cannot make use of this capital raising mechanism. In practice the sums raised via equity crowdfunding are very small. According to a report in 2017 the average amount raised by an SME through equity-based crowdfunding in the UK was just £770.[86]

In contrast to private equity, crowdfunding is open to retail investors. Indeed, the very low levels of minimum investment (often just £10) is an incentive for retail investors to invest, including those that might not consider the IPO market. The risks that such investors face are considerable.[87] Some of these are the same as the risks faced by investors in a traditional IPO; in particular there may be little information available regarding the business or its plans, and there is an asymmetry problem regarding the information provided, particularly in relation to retail investors, so that the securities offered via the crowdfunding platform may be hard to value. There are also some additional difficulties that investors in an IPO do not face; for instance, this is an investment in an unlisted company that is

[83] Equity crowdfunding involves investors investing via a platform, generally a website, which displays profiles of the companies seeking investment. This does generally involve shares, but some equity crowdfunding platforms are evolving to also offer debt securities.

[84] Prospectus Regulation art 15; FCA Handbook PRR 2.6.

[85] FCA Handbook, P.R. 1.2.

[86] CCAF, 'Entrenching Innovation', 2017.

[87] For discussion see FCA, The FCA's Regulatory Approach to Crowdfunding, Consultation Paper CP 13/13; FCA, The FCA's Regulatory Approach to Crowdfunding over the internet and the promotion of non-readily realisable securities by other media, Policy Statement, PS 14/4.

therefore illiquid. Although some platforms offer a type of secondary market, known as a 'Bulletin Board', which publicises expressions of interest by sellers and buyers, this market is restricted to those transacting on the platform and is not an extensive secondary market. Therefore, the exit options for investors are limited, unless the business is successful and is subsequently sold. In this way, the investment is more akin to an investment in a private company than to a purchase of shares in a company that will be publicly traded. These investments are also unlike a typical IPO, in that many of the companies involved tend to be small start-up businesses. Given the high probability that such businesses will fail, they therefore represent a high-risk investment for investors. There is a significant possibility that investors will not obtain any return (or any significant return on their investment compared to less risky investment options) and/ or lose some or all of their capital.[88] It is notable that the regulatory approach adopted to address these difficulties is distinct from that adopted in relation to IPOs. There is much less emphasis on mandatory disclosure and instead the predominant form of protection is to constrain the amount that retail investors can invest in equity crowdfunding, effectively requiring such investors to self-certify that they have not in the past year and will not in the following year invest more than 10 per cent of their net worth in unlisted securities.[89]

3.1.3 Comment

Private equity and equity crowdfunding provide two distinct alternatives to an IPO for companies wishing to raise equity capital from a group other than their existing shareholders. They offer an effective alternative source of capital for companies for whom the costs or regulatory burden of the public markets make that option unattractive or impossible. They bring with them risks and challenges vis-à-vis retail investors, however. In both cases the result is an unlisted security, but the operation of these mechanisms is quite different. Private equity (as distinct from venture capital) is a direct challenge to the IPO

[88] Even if the investment is successful, one risk that investors face is that they will rapidly be diluted when the company raises more finance and so will not receive the return on their investment that they might expect.

[89] For the restrictions on the persons to whom crowdfunded unlisted securities can be offered, see FCA Handbook, COBS 4.7.7-10. There are other forms of protection for investors too, in particular the crowdfunding platforms are regulated by the FCA as they carry out a regulatory activity (Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, Art 25) so that the FCA's High Level Standards and the Conduct of Business rules apply, as do the FCA's client money rules (CASS) to the extent that money is held on the platform.

market in that the companies involved are large, mature companies that might well otherwise look to the IPO markets for their funding; use of private equity investment certainly delays the use of an IPO and may mean it is sidestepped altogether if the exit from the portfolio company is a trade sale, for example. The private equity model avoids the costs and regulatory burden of the IPO regime by avoiding the public markets and, because retail investors cannot participate, much of the impetus for reform is bypassed; the regulatory focus is elsewhere and the burden is considerably lower than in the public markets. The growth of private equity has increased the options for companies and for sophisticated investors but may be regarded as a potential concern for retail investors who are unable to participate directly in the superior returns that are said to flow from this asset class. To the extent that private companies grow and mature without accessing the public capital markets, retail investors are excluded from participating in their growth. In the US, for example, companies such as SpaceX remain privately held.

By contrast, equity crowdfunding does not challenge the IPO market in any meaningful way, given that the companies making use of this form of financing are very small and early stage at present and not in a position to access the IPO market. Equity crowdfunding is interesting in the context of considering IPO reforms however in that it seeks to address the concerns about the costs of IPOs for SMEs by reducing the regulatory burden while still allowing retail investors to participate. This has involved less of a focus on mandatory disclosure and instead a cap on the amount that retail investors can invest.

In the Government's reform proposals, the changes recommended for the UK prospectus regime do not focus very significantly on the challenges and opportunities arising from the issues described in this section. While the proposals do aim to restrict the circumstances in which a prospectus is needed, for example by separating the concepts of public offers and admission to trading and adding new exemptions to the requirement to produce a prospectus, there is no real attempt to reduce mandatory disclosure for IPOs generally, or to investigate other mechanisms for providing retail investors with protection, such as those utilised in equity crowdfunding. Neither does there seem to have been an attempt to learn lessons from private equity (including the reduced regulatory burden there) which might be utilised in the context of the public markets without reducing investor protection, such as a reduced focus on short term profits and instead a focus on longer term performance and

strategies or perhaps an attempt to capture some of the corporate governance benefits of private equity. These are clearly not straightforward goals, but the lack of desire to address these issues is notable.

The Hill review recognised that there is an inherent tension between the desire to reduce the disclosure burden for companies and ensuring an appropriate degree of protection for investors, particularly retail investors, whose increased participation in capital raisings is identified as a priority, and who do not typically enjoy direct access to private equity.[90] While this is understandable it reflects a deep seated conservatism of approach and restricts the ability to find ways to reduce regulatory burden, make the public markets more accessible and attractive to a wider range of companies including early-stage companies and SMEs, and ensure that investors are protected. This conservatism means that there is a commitment to keep a significant mandatory disclosure regime at the heart of UK IPOs, and the reforms proposed are relatively limited. For example, the simplifications in the regulation of prospectuses to a large extent arise from a reduction of duplication. There is some recognition of the problems this causes for SMEs and early-stage companies. The Government's proposals make some tentative suggestions around alternative options for private companies wishing to offer shares to the public which are not admitted to a stock market, such as making their offers through authorised firms, but one of the options is to retain the status quo.[91] Alongside its general proposals to reform the prospectus regime, in July 2021 the Government launched a consultation to explore the possibility of creating a new class of trading venue for smaller SMEs. The paper suggests a threshold of £50m market capitalisation as a ballpark maximum issuer size for such a market, which is very large compared to many of the companies making use of equity crowdfunding, suggesting this is rather pitched as an alternative to private equity. The venue would be subject to more proportionate regulatory requirements tailored for smaller SMEs while preserving the high levels of investor protection. In particular, such a new venue would be subject to reduced requirements around company disclosure so as to encourage more companies to come to market earlier than planned.[92] Much will depend on the level of the reduction in disclosure and the resulting cost savings, but it seems doubtful that these relatively minor

[90] Hill Review, 32.

[91] UK Prospectus Regime Review n 22, ch 8.

[92] HM Treasury, Wholesale Markets Review, Consultation, July 2021.

changes will provide a meaningful alternative to private equity and equity crowdfunding for many companies, particularly SMEs.

The proposed changes put forward in the Hill Review and subsequent consultations fail to fully take account of the alternative options discussed in this section. The changes proposed are relatively limited and from a company's perspective they are unlikely to result in an IPO model that meaningfully competes with these alternatives. From the investors' perspective, it is unlikely that these changes will open up opportunities to invest in significantly different companies.[93]

3.2 Bolstering the public market

At the same time as the options for companies to raise equity from the private markets have expanded, developments have sought to make it easier and cheaper for companies to utilise the public markets for this purpose.

3.2.1 SPACs

The first innovation is the development of SPACs that have become an increasingly popular method of corporate acquisition, particularly in the US; during 2020 to the end of Q1 in 2021, for example, US SPACs raised on average more than $300m.[94] A SPAC is a company formed to raise money from investors which it then uses to acquire an operating business. SPACs are founded by a management team and are listed on a stock exchange through an IPO. At the time of the IPO, the SPAC has no tangible assets or business operations and their only assets consist wholly or predominantly of cash; investors in the SPAC are therefore investing in the ability of the management team to find an appropriate target to acquire. The sole purpose of a SPAC is to identify and purchase a business that is consistent with its investment objectives. SPACs are considered to be an attractive alternative to accessing equity capital markets through the more conventional route of a traditional IPO. One

[93] Notably, when the FCA consulted on a new category of authorised open-ended fund, the long-term asset fund (LTAF) which is meant to enable authorised funds to be set up to invest in long-term, illiquid assets (including private equity), the proposal was to restrict distribution of LTAFs to professional investors and sophisticated retail investors rather than retail investors more broadly: FCA, A new authorised fund regime for investing in long term assets, CP 21-12, May 2021.

[94] Deal Point Data, SPAC Market Study, April 2021. The Study also noted that the 2020 explosion in SPACs transactions resulted in a 320% increase in the number of SPAC IPOs compared to 2019, with the US being the main market leader.

benefit of using a SPAC is the significant amount of cash available to it for the specific purpose of making an acquisition, which removes the uncertainty associated with a failure to raise the required funds and the risk that the investors disagree with the SPAC management's valuation of the target. More significantly, however, companies going public via SPACs need only to be acquired and do not have to undertake the burdensome listing process that a traditional IPO requires, thus reducing the usual IPO timeline and arguably giving existing shareholders a quicker exit route.

The Hill Review noted that there are far fewer SPAC listings in London compared to competitor markets and identified a number of regulatory provisions within the UK listing regime that were acting as a constraint.[95] In particular the acquisition is treated as a fundamental change to the nature of the business of the SPAC and thus is classed as a reverse takeover.[96] This requires a relisting of the enlarged entity, which includes the cancellation of the existing listing and the need to go through the usual eligibility process to achieve re-listing and FCA approval of the re-listing prospectus. A particular deterrent identified by the Hill Review was the fact that the listing rules contain a rebuttable presumption that a SPAC's shares will be suspended from trading once it announces a potential acquisition;[97] investors in the SPAC are therefore unable to sell their shares and realise their investment until the acquisition is complete and a prospectus is published.

Subsequently, the FCA has gone ahead with new rules on SPACs which are designed to weigh the potential benefits of SPACs for issuers with the dangers for investors.[98] The main concern is that SPACs might encourage the listing of low quality or less mature companies on the London Stock Exchange through the SPAC route, due to the inevitable pressure on

[95] Hill Review, 29.

[96] It is worth noting that because a UK SPAC inevitably acquires the target in consideration for new shares, shareholders in UK SPACs gain additional protection because the reverse takeover inevitably triggers a Rule 9 bid, which can only be waived if the terms of the deal are approved by the Takeover Panel (see Takeover Code). This waiver requires competent and independent advice on the implications of the deal for shareholders and a vote on the deal by independent shareholders.

[97] FCA, Listing Rule 5.6. The basis for this presumption is that there will generally be insufficient publicly-available information about the proposed transaction and the SPAC will be unable to accurately assess its financial position and inform the market accordingly.

[98] FCA, Investor protection measures for special purpose acquisition companies: Proposed changes to the Listing Rules, CP 21/10, April 2021 (and the first London SPAC listing to make use of these rules, involving Hambro Perks Acquisition Co Ltd, took place in November 2021). For discussion of the reduced investor protection in SPACs see M Klausner, M Ohlrogge and E Ruan, 'A Sober Look at SPACs' European Corporate Governance Institute – Finance Working Paper No. 746/2021.

the management team of the SPAC to spend the newly raised cash on a deal given the limited time available in which to find the deal or repay the cash to investors. The danger is that the SPAC will overpay for the chosen target or not carry out sufficient due diligence on the target. As a result, the changes introduced by the FCA are relatively minimal: the presumption of suspension of shares is removed for larger SPACs (those raising at least £100 million at initial listing) as long as various additional investor safeguards are provided. These include a 'redemption' option allowing investors to exit a SPAC prior to any acquisition being completed; ensuring that the money raised from public shareholders is ring-fenced; requiring shareholder approval for any proposed acquisition; and a time limit on a SPAC's operating period if no acquisition is completed.[99] The assumption is that if the SPAC is of a minimum size it is likely to attract more experienced management and advisers who will be better able to avoid risks of overpayment and poor quality in the target, than a smaller SPAC. This cut-off is arguably somewhat arbitrary. These reforms are rather limited, but the FCA is right to be cautious. Concerns remain over disclosure standards and the share price performance of this model. It is not clear that SPACs are a proper structure to increase the number of IPOs while protecting investors.

3.2.2 Direct listings

A second alternative to a traditional IPO is a direct listing. There have been some recent high profile direct listings in the US, such as that involving Spotify in 2018 and Slack in 2019, and in 2021 the UK market saw its first direct listing of a technology company: the Fintech company Wise.[100]

Instead of new capital being raised and new investors being brought in, existing shares are admitted to trading on an exchange and the shares are listed. There is no offering of shares at a set price, and the price is established on the exchange by ordinary market forces. Instead of a formal bookbuilding process, the issuer usually holds investor days, at which relevant information is provided to a broad range of investors. Potential investors use this

[99] FCA, Investor protection measures for special purpose acquisition companies: Changes to the Listing Rules, PS 21/10, July 2021.

[100] This was the first direct listing of a technology company (in the vein of recent direct listings in the US), but the UK has long been home to so-called 'introductions.' A notable recent example is that of Metro Bank, which joined the London Stock Exchange in 2016, but without offering its shares to new investors (as would happen in a traditional IPO).

information, as well as the prospectus, to decide whether to invest following the listing. As is the case for an IPO, a prospectus is required for a direct listing on the main market as shares are still being admitted to trading on a regulated market.

One major benefit of direct listings are their lower fees owing to the process being shorter and there being no fundraising and therefore no underwriting fees. A direct listing therefore avoids some of the upheaval and expense of an IPO at a time when firms are finding it easier to raise money in private markets, as discussed in 3.1.

Direct listings will not suit all companies, however. In particular, the fact that no capital is raised will make it unattractive for many, particularly in comparison to a traditional IPO. Not all companies will be eligible either; under the UK Listing Rules, companies floating on the premium segment of the main market need to have a certain percentage of their shares in 'public hands' which could be seen as an impediment to some companies. Notably, the changes to the Listing Rules approved by the FCA in 2021 include a reduction of the required percentage of free float from 25 per cent to 10 per cent,[101] which may have a positive impact on the attractiveness of direct listings for some companies.[102] Another benefit of direct listings is their ability to avoid certain post-IPO restrictions, such as lock-ins which prevent existing shareholders selling their shares for a specified period of time. However, a direct listing exposes investors to some risks that are not associated with the traditional IPO route. Since direct listing does not use investment banks to underwrite the shares, the share price is purely dependent on market demand and there is often more initial volatility. To the extent that underwriters act as gatekeepers and provide some protection to investors,[103]

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[101] *See* FCA, LR 5.2.2(2) (regarding the FCA's power to cancel the listing of securities), LR 6.14.2(2) (regarding the shares in public hands requirement for premium listing), LR 6.14.2.2(3) (regarding the shares in public hands requirement for standard listing), LR 18.2.8(3) (regarding certificates representing equity securities of an overseas company), and LR 21.6.18(3) (regarding certificates representing shares of sovereign controlled commercial companies).

[102] UK Listing Review, 3 March 2021, and *see* FCA, Primary Market Effectiveness Review: Feedback and final changes to the Listing Rules, PS 21/22, December 2021. Indeed, and although the FCA did not specifically address direct listings in its consultation analysis of its free float proposals, it has acknowledged 'the potential benefit that [its] final rules to reduce free float could have for such listings' (*see* ibid, 27). At the same time, it is worth noting that the possibility of the FCA modifying this requirement to accept a lower percentage of free float if it considered that the market would operate properly with a lower percentage in view of the large number of shares of the same class and the extent of their distribution to the public has been eliminated (*see* ibid, 21ff).

[103] See J Payne, "The Role of Gatekeepers" in N Moloney, E Ferran and J Payne (eds) *The Oxford Handbook of Financial Regulation* (2015, OUP).

this protection is lost in the direct listing process. A direct listing is therefore riskier for investors, especially in its early days of trading, because it is prone to fluctuation.

3.2.3 Dual class shares

Dual class shares operate as a different kind of incentive for companies to utilise the public markets. Rather than seeking to reduce the costs, dual class shares offer founder shareholders an opportunity to retain a degree of control over the company even after there has been an offer to the public. In a traditional UK IPO listing on the premium market, with a one-share one-vote structure, founder shareholders and corporate insiders generally retain a relatively small proportion of the equity shares and therefore a similarly small proportion of the voting rights.[104] Dual class shares offer the opportunity to hold share classes with weighted voting rights. The weighted voting rights enable these insiders to retain a degree of control over the company that is disproportionate to their equity shareholdings even after the IPO.

Although UK institutional shareholders have traditionally been against the introduction of such shares in publicly traded companies, the recent revival of dual class shares in the US and reforms in the leading financial centres in Asia to accommodate listings with such share structures has brought this issue to the fore again in the UK. Those in favour of dual class shares point to the benefits of greater capital flexibility and the benefits of persuading entrepreneurs to utilise the public markets, giving investors (including retail investors) the opportunity to invest in companies that might otherwise remain in the private sector, and enabling founders to pursue a longer-term vision for the company. Those opposed to such shares cite the problematic implications that can flow from separating controlling shareholders' control from their cash flow rights, and corporate governance concerns given that such structures can entrench founder shareholders and reduce or prevent investors from having a say and holding management to account, although it is also possible for more traditional forms of investment (such as preference shares) to have a similar effect. Although founders can have significant shares in private equity transactions too, in that structure the private equity fund has a majority stake and the right to remove directors

[104] Dual class shares are permitted within the standard segment of the Official List. See eg Deliveroo Plc which had two classes of ordinary shares on admission of its shares to the standard segment of the Official List and to trading on the LSE main market, one with weighted voting rights.

which means that if there are concerns that the management strategy is not working, or there is drift and underperformance, this can be tackled. This is much harder if not impossible in an IPO with a dual class share structure. Where such shares have been introduced, there are often protections for investors built into the scheme, such as sunset clauses and enhanced disclosure requirements which seek to address these concerns.

The Hill Review supported the idea that dual-class share structures should be eligible for admission to the premium segment of the London market, but included a number of conditions, recognising the need for a balance to be struck between attracting founder-led companies whilst respecting the overarching principle of one-share one-vote that has been a cornerstone of the UK-listed company markets. The FCA has since given effect to these proposals and its Listing Rules now offer a conditional exception to the rule that restricts votes on matters relevant to premium listing to holders of premium listed shares only and allows holders of unlisted weighted voting right shares to participate in such votes.[105] In line with the recommendations in the Hill Review, the exception applies only where the class of shares with weighted voting rights obeys a maximum weighted voting ratio of 20:1 and is exclusively held by directors of the company.[106] Crucially, the weighted voting rights attached to such shares can only be held by directors of the company and are only available in two circumstances: votes to remove the holder of such shares as a director, and votes that follow a change of control. Finally, it is worth noting that this exception can only be relied upon during a five-year sunset period.[107]

3.2.4 Comment

One of the predominant concerns at the heart of the Hill Review and the various consultation papers and reforms from the FCA and Government that have followed it is a desire to find ways to bolster the UK IPO market. There is a significant regulatory competition element to this. Other jurisdictions have been developing alternative models to

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[105] FCA, Primary Market Effectiveness Review: Feedback and final changes to the Listing Rules, PS 21/22, December 2021. For discussion see E Lidman and R Skog, 'London Allowing Dual Class Premium Listings: A Swedish Commentary' (2021) Journal of Corporate Law Studies.

[106] The exception also extends to shares held by beneficiaries of a director's estates (*see* FCA, Listing Rules, LR 9.2.22C(3)).

[107] *See* FCA, Listing Rules, LR 6.9.1A, LR 9.2.21, LR 9.2.22A-LR 9.2.22A, LR 9.2.22F

attract companies and their founders to the public markets and this is undoubtedly an important prompt for these reforms. As the Hill Review states:

> 'Why do we need to act? Although listing on the premium listing segment of the FCA's Official List has historically been globally recognised as a mark of quality for companies, the figures paint a stark picture: between 2015 and 2020, London accounted for only 5% of IPOs globally. The number of listed companies in the UK has fallen by about 40% from a recent peak in 2008. Commentary about increased flows of business to Amsterdam make the point that we face stiff competition as a financial centre not just from the US and Asia, but from elsewhere in Europe.'[108]

That said, the reforms in this context (proposed and actual) are relatively limited. There is an understandable concern to ensure that any changes do not undermine investor protection, and as a result they largely tinker at the edges of existing structures rather than introducing wholesale change. While these investor-protection concerns are justifiable, the limited nature of the reforms will come at a cost. It is hard to see that these changes will be sufficient to achieve the regulatory competition goal of the Hill Review.[109] Whilst this may seem problematic, the UK is right not to push ahead with changes purely for the sake of responding to perceived regulatory competition. Some of these measures carry hidden costs for investors as other jurisdictions are starting to acknowledge.[110]

4. Conclusion

This is a period of significant change for the UK public markets, although the full extent of the change will only become clear as the various consultation exercises come to fruition. The current attention on reforming the UK regime is timely. Given the significant advantages of going public—both for companies and for investors—the UK should strive to make its public markets more attractive, particularly as the appetite for public investment seems to

[108] Hill Review, 1.

[109] In contrast to the UK's general reluctance to embrace direct listings, the US is also pushing ahead in this area: the SEC recently approving rule changes that allow primary direct listings (where companies can sell shares directly on exchanges without a traditional underwritten public offering) at both the New York Stock Exchange (*see* Securities Exchange Act Release No 34-90768 (22 December 2020)) and Nasdaq (*see* Securities Exchange Act Release No 34-94947 (19 May 2021)).

[110] For example, the SEC Chairman has put SPACs on the SEC's regulatory agenda with a view to potentially introducing tougher disclosure rules for SPAC (*see* Securities and Exchange Commission, 'Press Release "SEC Announces Annual Regulatory Agenda"' (Washington DC, 11 June 2021) <https://www.sec.gov/news/press-release/2021-99> accessed 12 December 2021.

be growing on the back of post-Covid optimism. However, any reforms need to balance the benefits to issuers from increasing access to the public markets and reducing regulatory burdens and costs, and the benefits to investors from increased options to invest in a wider range of companies (particularly early-stage tech unicorns), with the need to protect investors, particularly retail investors.

Although the Hill Review's proposed changes have been described as a 'fundamental overhaul' of the regime,[111] the changes proposed (and the changes introduced) to date are more limited than this rhetoric might suggest. In some regards this conservative approach is correct. In relation to SPACs, for example, the modest changes introduced by the FCA reflects the very real concerns about investor protection to which these mechanisms give rise. The UK is right to avoid joining a race to the bottom to attract issuers at the expense of investor protection. In other areas however the modest approach of the Hill Review and subsequent consultations and changes is less justifiable. In relation to the proposed reforms to the prospectus regime there is a failure to take full account of the successes of alternative capital-raising mechanisms such as private equity and equity crowdfunding. As a result, these reforms seem unlikely to provide companies with an IPO model that will operate as a meaningful alternative to these other mechanisms, or to address the concerns of retail investors wishing to invest in a broader range of companies than is available to them at present.

[111] UK Prospectus Regime Reform, 6.