Investment Exodus: London Stock Exchange

London Stock Exchange (LSE), a four-century legacy tracing its glorious heritage to the coffee houses of 17th-century London, is failing. The trading volume is sharply declining, and UK companies are swiftly moving to the US market. Listing in a stock exchange, in general, is meant to raise long-term equity capital for companies by offering shares to the public and institutions.

Unlike the UK listing, the US listing is relatively straightforward. For example— for LSE listing, the regulatory measures are stringent where companies need to raise capital and get approval from the Financial Conduct Authority (FCA). In contrast, in the US, the NASDAQ and the New York Stock Exchange both require companies' initial stock price, number of shares, number of shareholders and total market value. Once companies float their shares and start trading, they need less stringent standards to continue.

In 2023, the Nasdaq raised $13bn while the LSE managed $972m from the companies floating on it. Hosting more than 1000 companies across 70 countries with a staggering market value of £2.4 trillion is declining. The iconic index FTSE 250 is no longer attractive to investors, as a flurry of fleeing companies showcase the current investment exodus to the US. Two decades ago, UK-listed equities accounted for 11% of the MSCI World Index representing a sizable proportion of the global equity market, now they just represent a meagrely 4%. Recently, like many companies, Europe's largest travel company Tui bade farewell to the LSE. Since 2020, several LSE-listed companies, i.e., Abcam Plc, a Cambridge-based biotechnology company, Ferguson Plc, Smurfit Kappa Group Plc and CRH Plc have moved to the US.

More than thirty companies with market capitalization over £100m are leaving London's public equity markets. Thirteen companies have undertaken and completed takeover bids, seventeen companies delisted, and several small-caps companies under the £100m threshold going private, announced to delist. The aggregate market capitalization of LSE-listed equities went down to $3 trillion in February 2024, a 70% fall from $4.3 trillion in 2007, whereas the US market has exponentially grown three-fold to $53 trillion. The flagship LSE is suffering an unprecedented exit of companies under declining market conditions, having repercussions on the wider economic prospects.

From a theoretical perspective, the nexus between attrition and listed companies can be largely explained through the lenses of corporate governance, contracting, industrial organisation, and political economy (Meeks and Whittington, 2023).

Valuation matters

LSE-listed companies' valuation is relatively low compared to their US counterparts. IPOs on LSE fell substantially in 2023 as a host of companies opted for US listing for the opportunity of higher valuation and growth. Despite the liquid market rally, the value of PE monetization as a percentage of capital deployment remained below 40% in 2023. The valuation differential between both markets is considerably affecting the LSE listing. The earnings for the US-listed companies have been consistently growing, at a 3-year annualised return of 15%, revenues have grown at 9.1%, and the market trading is levelling at an average PE ratio of 27.9%. Unlike the UK market, the US market offers a higher valuation for the companies, a faster-growing equity market, fuelled by AI-led investor pools, and opportunities for short-selling. The UK market prefers long-term selling stocks which sometimes results in low growth and return. Recently, UK investors have withdrawn £8.9bn from the IA (Investment Association) UK all companies funds since no net positive cash inflow was experienced.

If valuation is the reason for the LSE delisting, what are the underlying drivers? UK investors prefer dividend-based returns, which can lead to underinvestment, particularly, affecting the new companies in the sector like technology and IT where high growths are customarily expected. Similarly, pension funds are less investing in the UK equity market and more in fixed-income assets, despite the Liquidity-Driven Investment (LDI) strategies of the UK which emerged after the "mini-budget" in 2022. However, the climbing interest rate after the mini-budget, almost forced UK pension funds to sell their assets undervalued to compensate for the liquidity call of LDI requirements.

The "Edinburgh Reforms"

The UK government urgently wanted to close the valuation gap with the US and placed the policy measures through "Edinburgh Reforms" in 2022. The "Edinburgh Reforms" proposes to replace the EU framework making LSE an attractive platform for companies, compared to the rival bourses in the US and Europe. The "Edinburgh Reforms" stipulate amending the companies' prospectus, considering short-selling, reforming the securitisation regulation, providing a better fund structure for the UK market through the new UK Long-Term Asset Fund (LTAF) and establishing the independent investment research review. Despite UK listing regime reforms, the number of companies listing in LSE is declining (Cheffins and Reddy, 2023). Similarly, the UK Treasury Committee comments that there has been little progress made since the reform package was set out.

What can be done?

Since the LSE Refinitiv deal, the LSE has been less focused on the exchange side, and more on data analytics, given the emergence of data-interfaced trading. Although, desirable but LSE has not been able to create synergy in their indexes and is subsumed by the hefty cost of the deal. Therefore, LSE should set a clear mechanism to definite the interplay between data analytics and trading exchange so that multiple-class and dual-class shares can be efficiently traded. As it stands now, unlike the US, companies with multiple-class shares or dual-class shares are rarely common in the UK.

LSE could potentially revamp the valuation of delisted shares before they go for liquidation. Both NYSE and NASDAQ offer provisions for delisted shares to move on to the OTC (Over-the-Counter) Markets to continue trading enhancing the fungibility. Simplified stimulus measures such as tax breaks, less administrative burden and more leveraging "ease of investments" are venues for LSE to consider. In addition, the LSE should address the cross-border pay differentials (Reddy, 2024). Since UK shareholders have a controlling "say" compared to the simple advisory role of US shareholders, the compensation agreement remains a change for the UK equity market.

The geo-political agendas are significant determinants of market prospects. FTSE All-Share shows a sharp volatility before, during and after the election for over six months. Given the UK general election is drawing closer, several complex factors are at play— how effectively defined-benefit pension plans are to be executed since UK pension funds hold a sizable portion of UK-listed shares, the compensating cost of Ukrainian and Palestinian wars, and political parties manifestos.

Nevertheless, this is a period of reckoning for the LSE, investors, and regulators, alike.

References

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