Comment

Shrink to fit a global niche

__Martina Garcia__ explains why stock exchanges are undergoing a consolidation, which could be good for UK companies even if it means a new role for the London Stock Exchange

There have been a lot of headlines lamenting the decline of the UK public equity markets and the loss of competitiveness of the London Stock Exchange. Companies from many sectors are increasingly signalling their preference for a listing in New York – attracted by the prospect of higher valuation and liquidity. We are told reform is urgent to stop the London bourse becoming a backwater.

But that outcome would not necessarily be bad news for the UK economy. What commentators never mention in their prescriptions for restoring the health of the London equity market, which usually include loosening listing rules and making it easier for pension funds to invest in domestic equities, is the underlying structural shift in capital markets.

Bourses offer a mature product, with increasingly marginal returns. In a world of free movement of capital and information, consolidation is unavoidable. Before the second world war, there were 22 stock exchanges in Britain alone. Nowadays, few countries have more than one, and it often survives only because politicians want a national champion. Bourses and airlines have more in common than people think.

This is why Xavier Rolet, the then Chief Executive of the London Stock Exchange Group, was so keen to merge with Deutsche Börse before the deal was finally quashed in 2017. He predicted that by mid-century only three markets would have global clout: New York for the Americas' time zone, Shanghai for the Asian time zone, and a European one for Europe/Africa.

For the London bourse to have sufficient scale to be the chosen European exchange, it would have to consolidate with other leading European bourses. The unravelling of the merger and, crucially, the post-Brexit fragmentation of European capital markets mean that London is now unable to play that role.

But the loss of London is not good news for European bourses either. Post-Brexit, they have gained a few listings and an uptick in the rankings, but they also play second fiddle to New York. For example, Ferrovial, a leading Spanish infrastructure group, triggered much angst when it announced it would move its listing from Madrid to Amsterdam in order to prepare a further move to the US. The reality is that, without London, even full consolidation across EU exchanges might not keep Europe's largest companies listed in the EU.

From an economic growth perspective, the exodus to New York and other global hubs is good news. If UK companies get better valuations, they can invest more. If UK asset owners get a better return, UK investment and disposable incomes will be higher. Even the London Stock Exchange Group will be fine. According to its latest annual report, equities markets (capital raising and trading on the LSE and Turquoise) represent only 3.4% of the group's revenues. Yes, the City's financial services cluster might lose some network efficiencies if large equity-focused teams disappear from the area, but there is likely little choice.

Choosing the right strategy

So, what to do? There are three main strategies for UK policy makers and market players. First, try to delay the inevitable by tinkering with listing rules, reducing stamp duty and putting political pressure on companies and asset owners to 'list British'. It is the equivalent of subsidising the national flag carrier, very tempting politically but ultimately a costly white elephant. In particular, it would deprive companies and investors of access to more efficient capital markets.

Second, try to compete on volume with New York by having a bonfire of listing requirements. That is a risky strategy. Deregulation, particularly at the beginning, inevitably attracts companies whose corporate governance standards exclude them from other bourses. It would only take a few scandals for investors and good companies to flee, never to return.

The third option is to build a global niche on London's three current strengths: its premium market, its international experience and AIM. The premium market would have to become more international-friendly, in particular it would have to replace obligations to adopt the UK corporate governance code and also reform the UK legal framework on settlement to service non-UK plcs and multiple currencies. Developing AIM would require exploiting fintech and AI innovations to reduce trading and disclosure costs while improving transparency and liquidity.

A niche global strategy has a realistic chance of long-term success and would provide the opportunity for UK large and small companies and investors to benefit from the best markets in the world while preserving a vibrant, even if smaller, equity market in London. ■

__Martina Garcia__ is the Director of the Centre for the Study of Financial Innovation at the LIBF. Her career spans more than 20 years and includes senior roles at the London Stock Exchange Group, the Treasury and the OECD