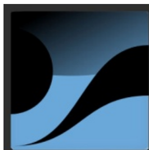

ShareSoc

UK Individual Shareholders Society

PO Box 62, Chislehurst, BR7 5YB
Phone: 0333-200-1595
Web: www.sharesoc.org

Improving the AIM Market

The London Stock Exchange (LSE) have recently published a document entitled "AIM 20 Report 2015" which is available on the web. It's basically a puff for the AIM market on its 20th anniversary and covers 20 case histories of successful AIM listed companies - including such companies as AB Dynamics, Advanced Computer Software, ASOS, Domino's, Chi-Med, Imperial Innovations and others.

There is no denying that it is possible to invest in successful AIM companies but as any experienced AIM investor knows, doing so consistently and avoiding those that either never establish a profitable business, get delisted, go bust or otherwise become the walking dead is another matter altogether. Picking out the quality companies that will give a good return from buying their shares is not easy and in comparison with main market companies it is a minefield for inexperienced investors.

The AIM 20 Report actually says in the introduction that over 3,500 companies have joined AIM in the last 20 years. How many are left? Well it does not say but the answer is 1,044 according to the last published AIM Factsheet from the LSE. Now some will have moved to the main market, and some will have been taken over (not necessarily at a profit for the shareholders from their original investment), but clearly there is a very large amount of turnover in AIM companies. Many will have gone bust or been delisted. Or as Claer Barrett said in the Financial Times: *"20 years of a few winners and many losers".* She reported that over the last 20 years investors would have lost money on 72% of AIM companies, and in more than 30% of cases they would have lost more than 95% of their investment.

One only has to remember recent cases such as Globo and Silverdell, or companies such as Izodia, Versailles and Langbar, or the numerous oil/gas or mineral exploration companies some of which were of course simply fraudulent businesses. Do the few, sometimes massive, winners offset the losers? The answer is no. The AIM index has underperformed main market indices over the last 20 years.

So what is wrong with AIM? Some people think nothing at all. This is what the editor of Shares Magazine, Daniel Coatsworth, had to say recently: *"The general consensus among fund managers, corporate brokers, nomads and stockbrokers is that there doesn't need to be more regulation".* The LSE has consistently defended the way AIM operates and claims it is one of the most successful small cap exchanges in the world. But many private investors would not agree.

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Note that these problems are not solely focussed on foreign companies that list on AIM - such as the recent spate of dubious Chinese businesses a number of which have been delisted of late. Only 650 of the 3,600 companies that have listed on AIM came from outside the UK, but one does have to ask why they bothered to list in the UK rather than a market closer to home. The suspicion is that the regulation of AIM is more lax than other markets they could use although they could argue is it is also lower cost. But it does appear that a number of Chinese businesses have been used in this way to move shareholdings outside of China to places like the Channel Islands or mainland UK - in effect providing a money laundering exit.

The view of many private investors is that AIM is full of dubious businesses led by dubious people. New companies often go onto AIM with no established business model (in other words, a model that will clearly generate some profits in the future even if it does not now) and often with no revenue. There have been lots of cases of downright fraud and false accounting, and even when there is no obvious fraud companies often make announcements that are misleading for investors (for example announcing director share purchases when they were in fact sales). The directors of some AIM companies, and their advisors, seem to take the view that "anything goes" so long as they can spin a good story around it. Or they delay announcements to defer knowledge of bad news, fail to disclose director dealing and if they run out of cash they simply do a heavily discounted share placing to themselves and their pals which dilutes private investors who cannot participate. The ethics of those involved in AIM companies seem questionable in many cases.

The AIM market seems to be run for the benefit of the LSE, for company brokers, for private investor stockbrokers and of course for the company directors and other "insiders", but not for outside investors.

It is a market that is "self regulated" and the regulation is weak as is usual with self regulated markets. Any infringements are not vigorously pursued and even if complaints are upheld the judgement may not be published. There is no "naming and shaming" as a matter of principle.

Nomads and company brokers are often the same organisations so there is a massive conflict of interest there. While Nomads are supposed to act as proxy regulators, ensuring the companies do the right thing, the broker is there to promote the company - to push the good news and conceal the bad as any PR operation does.

The reputation of AIM is such that it actually puts off good quality companies from listing on it. For example, those boring yet profitable businesses that are resident in the UK. The directors of such companies also see little point in listing if liquidity might be low, they are burdened with the regulatory and listing costs, and future fund raising might be more difficult. Tighter regulation is a two-edged sword. It might improve the market for investors but raises costs and deters new listings.

There have been many calls for the reform of AIM, so the key question is what to do about it. Below are some suggestions for what could be done and readers are welcome to contribute further suggestions.

1. Tightening the regulations (except in certain specific areas) seems unwise for the reasons given above. However the regulations that exist should be enforced more vigorously, complaints upheld should be publicised and the names of the malefactors published. Complainants should be advised of the outcome of the complaint and have a right to appeal to an independent ombudsman if they are still dissatisfied.

2. The roles of Nomad and Corporate Broker should be separated, i.e. it should not be possible for the same organisation to have the dual role. Alternatively regulation should be supervised by an independent regulator which is financed out of listing fees.

3. A Corporate Governance Code should be introduced and mandated for AIM companies similar to the main market or QCA codes. For example, having an independent non-executive Chairman and a majority of non-executives on the board for larger AIM companies would improve the quality of corporate governance.

4. There should be regulations laid down by the LSE on remuneration reporting and votes at AGMs to approve director remuneration, similar to but in a simpler form to that of the main market so that directors cannot abuse their position with excessive pay schemes.

5. The directors of AIM companies should be required to have some training and specific qualifications in the law affecting companies and their directors, and their responsibilities under the Companies Act. That is particularly the case for non-executive directors. At present we see too many cases of directors acting in a cavalier fashion and with complete disregard to their fiduciary responsibilities in a general sense.

6. There should be regulations introduced to limit share placings, particularly those that are heavily discounted, where there is no associated open offer. Placings should require the approval of a majority of shareholders other than those representing directors interests and directors should not be able to participate in discounted placings. In addition where a book build for a placing is taking place, the shares should first be suspended until the placing is complete as it is clear that information about placings often leaks out in advance at present.

7. An independent panel of experienced investors (both private and institutional) should advise the LSE on the suitability and quality of proposed new listings to remove some of the dubious applications that seem to get through at present. Particularly scrutiny should be made of those businesses that are unprofitable or have no significant revenue, i.e. the "story" stocks where their merits depend on future projections which may or may not come true. Such an independent panel should have the ability to veto any proposed listing, or delay it.

8. Nomads, or any independent regulator, should have clearer responsibilities to investigate the affairs of AIM companies both before and after listing. That is particularly the case for foreign registered or operated businesses. They should have a duty to respond to, and report back to the complainants when any complaints about the activities of a company and the directors are reported to them. In other words they should have a legal responsibility to shareholders as well as to the company who pays them and to the LSE.

9. There should be limits on the number of roles in different companies that non-executive directors can take - no more than 3 as a maximum so as to ensure they have adequate time in which to supervise the activities of companies. In addition they should be truly independent and not have any familial or business relationships with other directors.

10. The LSE should introduce regulations that AIM companies must hold General Meetings within the UK at a reasonably accessible location and at convenient dates and times, and always give at least 21 days notice. In addition the company should give a presentation at such meetings, allow nominee shareholders to attend and ask questions (upon the provision of reasonable evidence that they are shareholders, directly or indirectly, in the company).

11. All directors of AIM listed companies should be fluent in both written and spoken English and should respond to questions from any shareholders. Note: this and the immediately above proposal would severely limit the number of foreign companies who would be able and willing to comply but that would be no bad thing.

In conclusion, all of the above steps would improve the quality of AIM listings without incurring significant extra costs or the use of management time in AIM companies. Any slight increase in costs arising from the need for adherence to corporate governance rules or remuneration reporting should be offset by the improved reputation of AIM companies that might result.

Roger Lawson, Deputy Chairman, 3/6/2016 © ShareSoc (Last Revised 3-Jun-16)