



UK Smaller Growth Company Survey 2018

October 2018

*Report researched and written by
Sohail Jain, MBA graduate student at
Cambridge Judge Business School (CJBS)*

Foreword



By David Barbour
Managing Partner of FPE Capital

FPE Capital has been focussed on helping smaller UK companies with their growth and expansion since 2008. This has given us a privileged view of the changing attitudes and concerns of founders, entrepreneurs and management teams with high growth companies across the last ten years, from the credit crunch through to the current more positive economic environment, and the imminent prospect of Brexit.

We have decided to sponsor an annual survey of growth company attitudes to share these insights and give the companies in this key part of the UK economy a voice to express some of the less reported issues they face. Whereas many surveys focus on quantitative statistical outputs, we have rather sought deeper insights through lengthy one to one interviews with a range of founders, entrepreneurs and CEOs within growth companies.

The clear message from the sample companies is one of strong confidence in their growth prospects – with over 85% of respondents “very confident” about the year ahead and their prospects. A majority are planning to grow their employee base at a faster rate than last year, and a larger majority are planning to increase their internal investment at a faster rate than last year.

Against this positive backdrop, our discussions have thrown out some fascinating recurring themes and also some clear divergence of opinion. There is widespread agreement on the shortage of developer skills for technology enabled businesses, by far the strongest area of current concern. In contrast, on the funding side there are some companies finding growth capital relatively plentiful and easy to access while others feel the system remains opaque and poorly signposted, with banks criticised for their lack of support growth plans. And despite the technology driven nature of the sample businesses, that old bugbear of business rates produced perhaps the most emotional responses.

We are delighted to have sponsored Sohail Jain, a recently graduated MBA student from the Cambridge Judge Business School (CJBS) to carry out the first of these studies and we intend that a CJBS student will do this annually. FPE Capital has a particular connection to CJBS through our design and sponsorship of an annual portfolio company management programme at CJBS focussing on the challenges facing management teams within high growth companies. We thank all at CJBS for their continued assistance.

We hope you enjoy the report and find it of interest. Please do let us have any comments.

Regards

David Barbour



respondents
“very confident”
about the year
ahead.

FPE Capital would like to thank each of the fantastic high growth smaller companies that gave their time to participate in this study.

Introduction

The purpose of this paper is to assess the current environment for a selection of smaller UK high growth companies generating revenues of between £5-£25 million and to outline the key challenges they see in the coming 12 months.

FPE Capital has analysed this segment of the UK market as comprising over 55,000 companies and by similar segmentation approximately 30% of UK businesses, by revenue and employment share, are classified as small-medium businesses. Often referred to as the engine room of the UK economy, this is where high quality new businesses and jobs are being created in innovative and often technology led businesses.

The survey and this report are intended to provide a voice for the concerns and issues of these smaller high-growth companies, which are often under-represented in the national press and in academic research. This paper

will be the first edition of an annual study, to shed light on challenges these companies foresee over the coming year, and how they are seeking to address them.

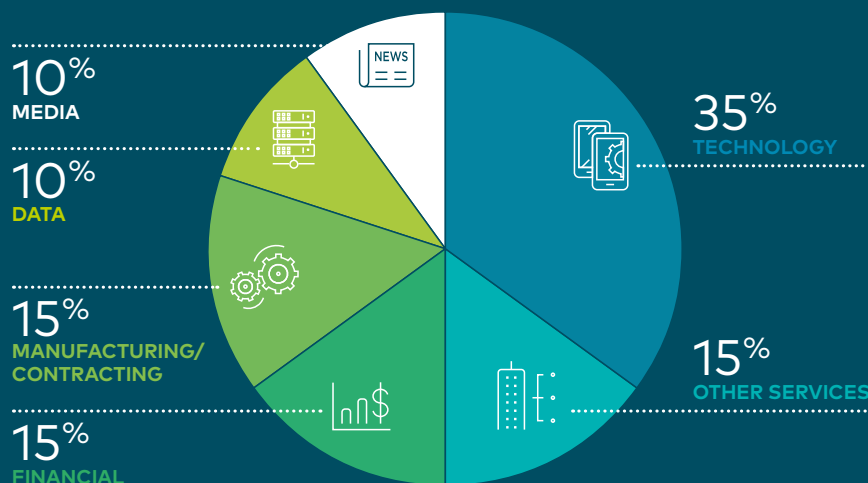
Scope

This study was conducted in a qualitative manner in the form of primary interviews with senior management of higher growth smaller companies over four weeks. This paper is not intended to be statistically relevant given its relatively limited sample size. Nevertheless, its qualitative approach has produced a few recurrent key themes and highlights interesting anecdotal evidence of common concerns amongst the respondent companies.

The participating companies for this project are not disclosed in order to protect their confidentiality. We sincerely thank each of them for their time and co-operation.

The respondent companies break down by sector focus as below.

Industry groups of survey participants



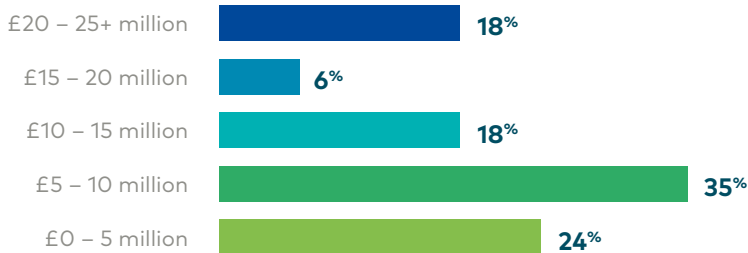
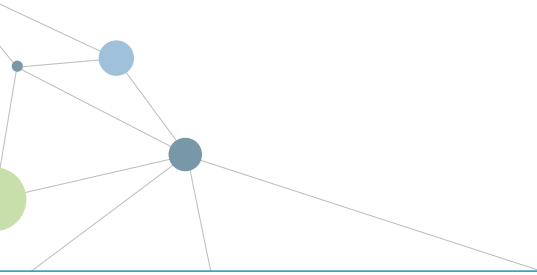
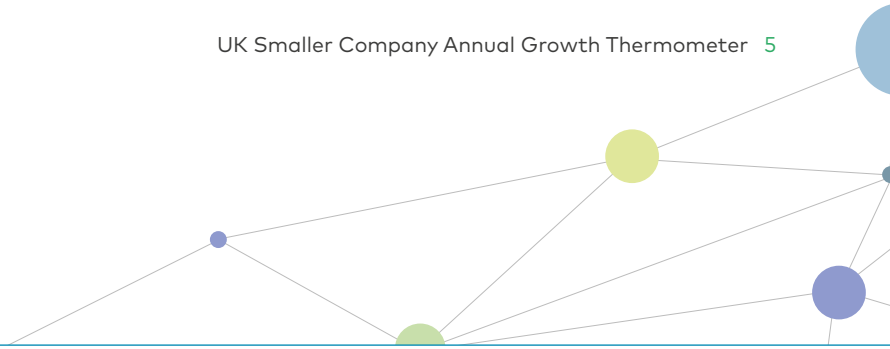


Figure 1. Revenue range of survey participants

The stage of the business surveyed was predominately in the "growth stage" once a business has reached some initial level of critical mass and commercial traction, but does include a number of earlier stage businesses.

Prior to conducting the primary interviews, various existing research focused on the small business space was reviewed to narrow down the principal areas of challenge faced by this segment of the market. Appendix B highlights the secondary sources referenced. The interviews then focused on the following ten categories, which were used as a basis to structure discussions with respondents. Respondents were asked for additional areas of concern additional to these areas, but few raised concerns not captured in these categories.

1. Talent acquisition and employee costs
2. Macroeconomic factors
 - a. Tariff/ trade related issues (including Brexit)
 - b. Inflation, Currency, Interest Rates
3. Availability and pricing of financing (equity and debt)
4. Working capital terms with key customers / suppliers
5. Government policy / tax / regulation
6. Barriers to domestic and international growth
7. Competition
8. Business scaling / customer acquisition
9. Research & Development
10. Infrastructure and/or systems for growth



Confidence barometer

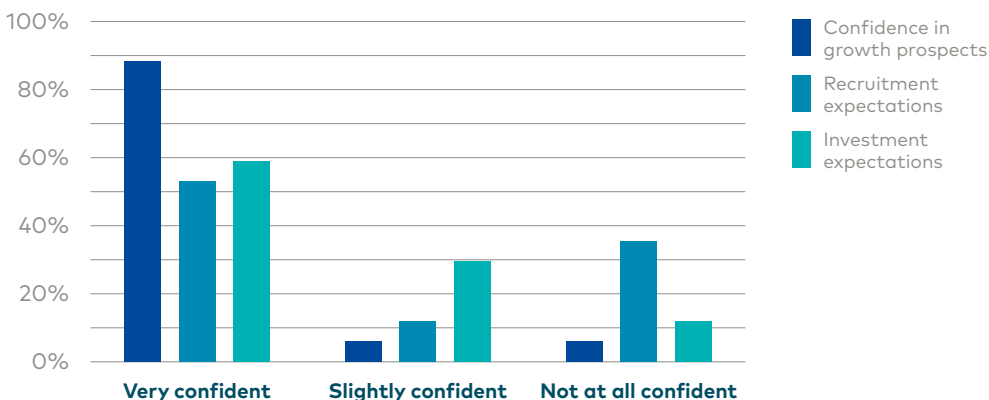
We asked each company three questions

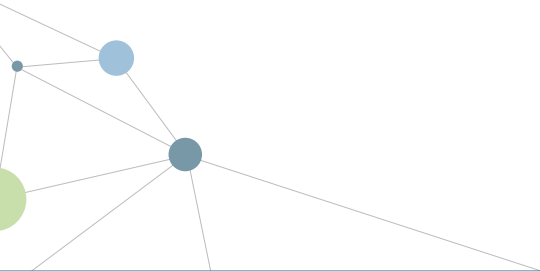
- How confident do you feel about your company's growth prospects for the coming 12 months?
- Do you expect to recruit more employees in the next 12 months than the past 12 months
- Do you expect to investment more into your business in the next 12 months than the past 12 months

The clear message from the sample companies (figure 2) is one of strong confidence in their growth prospects – with over 85% of respondents “very confident” about the year ahead and their growth. A majority are planning to grow their employee base at a faster rate than last year, and a larger majority are planning to increase their internal investment at a faster rate than last year.

The positive message reflects a group of companies chosen randomly but from the sectors in which FPE Capital searches for investment opportunities – technology enabled business to business companies in the broader services sector. Again, it is not a statistically relevant sample but this optimism is pervasive and the survey results should be seen in that context.

Figure 2. Confidence barometer





Survey results - key challenges raised

Each respondent was asked to identify up to three challenges that they deemed most applicable to their businesses. Interviews were discursive in nature, focused on those challenges. An indicative overview of discussion topics is included in Appendix C. A summary of the interviewees' most frequently highlighted challenges is set out below (figure 3).

I. TALENT ACQUISITION AND EMPLOYEE COSTS

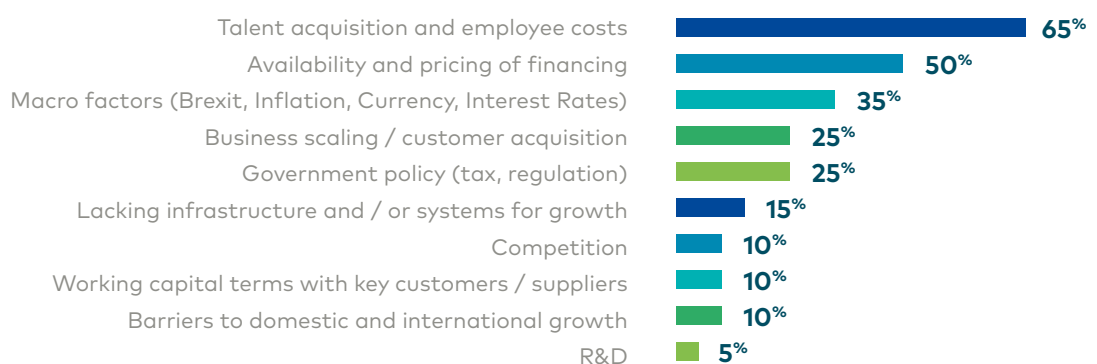
Summary: *this is the key area of challenge for high growth companies surveyed. There is a particular challenge hiring developers, and very interestingly an additional challenge in getting developers to work as full-time employees, with many preferring the flexibility and challenge of working as contractors. The advantage smaller entrepreneurial companies have as 'challenger brands' is being threatened by the tech 'giants' and their high profile among younger workers.*

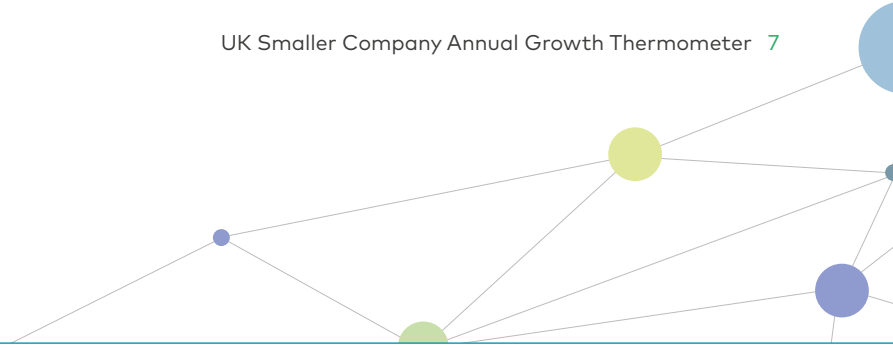
Talent and hiring was by some measure the most pressing concern for the sample companies. Within this area, it is clear that most interviewees were more concerned about the difficulty and challenges of talent acquisition rather than employee costs. Many noted that, with the UK economy being close to full employment, it is increasingly challenging to recruit high-quality talent. No doubt the weighting in the sample towards high growth businesses with human capital at their core influenced this response and with smaller companies appearing more aware than ever of their reliance on recruiting good teams, talent management was the most significant and most frequently identified challenge in the survey.

The most frequently cited talent shortage was for skilled technology developers.

"Tech development talent is incredibly scarce in the UK....if you have high quality full stack developer skills you can name your price, which is not a good thing..... and the skills are very transferable."

Figure 3. Top challenges for the interviewee companies





Every technology focused company we spoke with highlighted there is a significant developer shortage in the UK that is constraining technical progress and increasing staff costs. To counteract the lack of developer talent supply, several companies outsourced work to Eastern Europe or Asia, but many respondents noted that this is a sub-optimal solution. Firstly, asset-light companies are especially protective of their IP and focus on the loss of security and product control when outsourcing. Secondly, several CEOs noted the loss of team culture when outsourcing key roles from a small company.

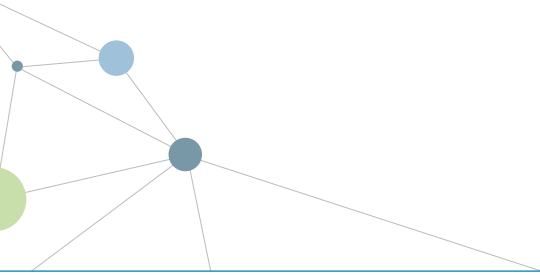
Anecdotally, some respondents also described having been forced to relocate top-quality overseas contractors to the UK in order to keep them, thus defeating the objective of offshoring. Executives also reported progressive erosion of the cost advantage of offshoring, most particularly in Eastern Europe, where labour pools are thin and wages sensitive to increases in demand from overseas. Conversely, certain of the larger companies in the sample (which have been outsourcing for over five years) reported having established effective outsourcing solutions of scale.

"It is difficult to get good developers to work as permanent employees...they like the flexibility of contracting...contractors feel they can 'have it all'... they take the more interesting roles and avoid the dull jobs, plus they often want the flexibility to work remotely."

Many developers choose to work as contractors, due to an advantageous tax position, flexibility and high day-rates; this is frequently disadvantageous for the employer. This issue came up several times and is a material frustration to businesses looking to build stable teams with ongoing continuity of in-house expertise.

The second talent shortage discussed by a few companies was in relation to skilled sales people or account managers; finding individuals with the right balance between numerical, commercial and interpersonal skills were particularly difficult. Furthermore, in several instances amongst our respondents, companies marketing new products found it hard to determine appropriate targets for their sales team. One CEO reported achieving 20% annual revenue growth but being unsure as to how well his sales team had genuinely performed. In addition, many recognised that the timing of hiring sales people is key. One company indicated that their initial sales targets were met entirely through online channels, reaching over 100 countries. They have however recently hired sales people in Asia, where they perceive that cultural factors place a higher value on face-to-face interactions. Another participant highlighted that even with strong growth ambitions, it is important to note that over-hiring sales people can reduce returns, and it is important to build a broader marketing strategy as part of a go to market plan.

Many companies raised as a challenge the relative difficulty they face in attracting talent when competing with larger companies that offer higher pay, greater job security and more attractive employee benefits. While it is clear that the attractions of an entrepreneurial environment are increasingly well understood, especially over the "old economy", it is also clear that smaller technology companies face a further issue in competing for talent with



the likes of Google and Amazon. The issue was, not surprisingly, more acute for those companies seeking to attract talent closer to the larger metropolitan areas. The report's sample is weighted towards companies headquartered in the south east of the UK, which may contribute towards the strength of this latter concern.

One successful software business located in a quiet market town had found its local employment pool a constraint. It has used a satellite office in Bristol to access younger technology talent and has a major operation in Bulgaria. The CEO emphasised the importance of regular contact with those offices through personal visits and face to face interaction.

"We have developed a hub in Bristol and one in Bulgaria... it's been a real success, but I have to make sure senior people in the business spend face to face time in those offices"

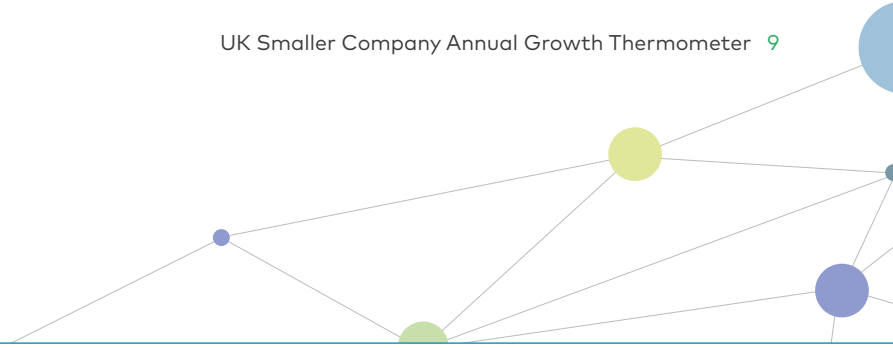
"We can't compete with big tech for the best talent – we can train our own but then there is a battle for mid-level skilled staff so it's about building loyalty."

Several participants cited their primary competitive options in attracting talent as raising base salaries, remunerating employees via equity stakes, and non-monetary incentives. Whilst the prospect of participating in a successful 'exit' can be attractive to those joining small, growing companies, respondents nonetheless identified the relative illiquidity and lack of transparency of equity ownership versus sophisticated share schemes run by listed technology 'giants'.

Interestingly, interviewees highlighted reputation as being an attractive draw for good talent. For example, should a team be highly successful in a smaller high-growth company, they are more likely to be noticed by industry peers rather than being lost within a large corporate entity. Smaller companies clearly need to focus on building their brand and profile for recruitment - the larger tech companies have an obvious head start here. Non-monetary incentives were also identified by interviewees as being important to attract talent, and include promoting a work-life balance, building team culture, and locating (including satellite offices) in relatively affordable areas to aid employees' cost of living.

Another challenge sometimes highlighted by survey participants was the difficulty in retaining employees and the difficulty in recruiting the right employees.

One company highlighted that a lack of structure or processes at smaller companies compared to larger firms can prove to create a challenges for applicant individuals who prefer structured work environments. This has resulted in some respondents seeing significant staff turnover and therefore an increased requirement for investment in training staff (over six months per hire).



The pace at which some start-ups set their growth plans can lead to accelerated recruitment processes, which some respondents recognised had in some cases resulted in a lack of clarity to potential employees about their work environment and expectations of them.

"We have grown from 3 to 35 employees in three years...we now have one employee doing nothing but recruitment."

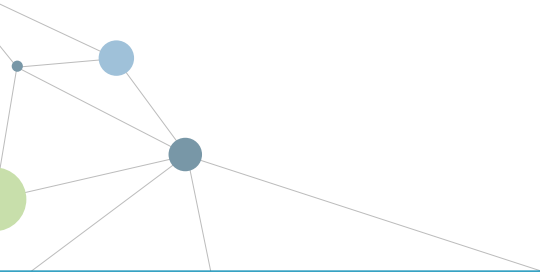
Respondents identified more rigorous recruitment processes (e.g. multiple interviews with new hires) and better communication of values and culture to employees at the recruitment stage as solutions to this problem. Several companies discussed hiring the wrong employees in their haste to scale rapidly. The main mitigating action appeared to be a more rigorous interview process. One interesting illustration was that of a company that at peak grew to 185 staff, and subsequently downsized to approximately 40 staff. This was achieved by outsourcing several functions overseas and was driven by the founder's realisation that many of his new hires were not accretive to the business.

A separate 'talent' issue frequently identified is the need to bring in professional management teams once the first phase of growth phase has been achieved, when founders believe they have taken the company as far as they can, or when investors believe a new team is required. Finding the right senior management team is recognised as critical; several respondents reported positive management team changes, while several others reported poor hires.

One founder brought in a highly analytical management team, but found that this caused the company a damaging loss of dynamism. By contrast, another interviewee, who had recently taken over as CEO from a company's founder, felt that professional managers have to drive a cultural shift to higher quality decision making (e.g. based on data). This CEO was recruited as the company's founders wanted to professionalise their business ahead of an exit to a strategic buyer. In practice, however, the founders found it difficult to let go and remained involved in decision making, which proved disruptive to employees and customers and restricted the new CEO's ability to drive change.

One factor that came up in two specific cases may give smaller companies pause for thought on where they locate. While locating in metropolitan hubs near large workforces might seem the obvious strategy, two firms in more provincial locations reported greater staff loyalty and a definite advantage in offering a quality of life, short commute and (implicitly) a more difficult decision for employees to leave – as that would almost certainly increase their time and cost of commuting. This may be something for founders and CEOs to think about – this upside may compensate for other downsides of being in a smaller town.

Overall, talent acquisition, retention and recruitment of professional managers are clearly key areas for smaller companies and attracting and retaining talent is an issue that is consistently front of mind amongst our respondents.



II. AVAILABILITY AND PRICING OF FINANCING

Summary: *Private companies have had varying experience of the current fundraising market – some recognise the wider availability of growth capital but experiences with private equity firms remain mixed. In many cases there is resentment at the terms of financing offers. Interestingly, none of the interviewees pointed to banks or other lenders as a credible source of growth capital.*

Development / Growth Capital

Many of the companies interviewed are considering raising growth capital or are eventually looking to prepare for a sale, and thus identified the private equity market as their primary financing goal. Some interviewees believe there is a significant level of capital within PE firms to be deployed, which they perceive to have driven up valuations. Despite this, there was a mix of reactions to how companies found their interactions with private equity firms.

“We will raise a funding round next year and have raised some venture debt to get us through to that....”

Some – but more frequently the early stage respondents – commented that the balance of power still lies too much in the financiers' hands, resulting in overly punitive terms and outsized returns to investors if the business performs to plan, whilst investors often take a liquidity preference if a company underperforms.

The challenge is finding the right PE investors – their criteria isn't always clear.

However, another interviewee that had just completed a Series B funding round had a very positive experience when bringing in an investor, and felt their strong leadership team and quality of their business drove favourable terms. They received numerous financing offers and were able to choose their optimal partner.

Companies with US expansion plans and experience with US investors noted that US investors appeared more willing to take risks and offer higher valuations than UK investors. Interviewees believed the likely reason for this was related to the size of total addressable markets in the US driving outsized returns for successful market entrants.

UK lenders

The UK bank lending market was cited as a tough proposition for companies without at least three years of strong trading and/or the ability to pledge security to lenders.

Pledging security appears – for obvious reasons perhaps – a particular issue for asset-light or service-led companies. The companies that did make use of banking facilities tended to use working capital lines to support their

cash conversion cycle, and after building a track record of utilising a facility they found further financing available to them, including term loans. None of the interviewees pointed to lenders as a credible source of development / growth capital.

"I built my business with my savings and personal loans, expressly so I could then access bank funding. But when I needed them, they weren't responsive."

Government Grants

Respondents that had obtained government grants found them to be broadly helpful, notably government-sponsored innovation grants focused on the tech industry. One of the technology companies we spoke with did not believe these grants necessarily incentivise optimal behaviour. In their case, government grants were available to fund recruitment; these encouraged disproportionate increases in headcount rather than incentivising product development or marketing. The administrative burden of reporting on employee count (as required by the grant) was also cited as onerous.

Other Sources of Funding

Several further sources of equity, lending and government-led financing were identified. Certain of these hold attractive characteristics such as long-term capital provision and 'softer' money than private equity funds or bank lenders, although these schemes are more likely to be subject to restrictions on usage (e.g. focused on

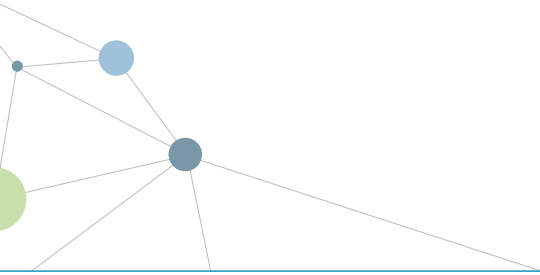
growing employment) or changing political circumstances (e.g. uncertainty around EU sponsored funding sources for UK companies)

III. MACROECONOMIC FACTORS

Summary: *Brexit was the key issue here - but interesting to note that it crops up only among the third highest issue for concern. Labour related impact of Brexit a strong issue. Despite the lack of any real consumer/retail businesses -those currently seen as weakest - within the survey, there was a general feeling that the economy was not in a strong position. Most interestingly none of the companies voiced expectations of a positive impact from Brexit (ie through easier trade relations / opportunities outside the EU). Smaller companies are aware of the potential dangers of certain Brexit scenarios but are unwilling/unable to spend money on contingency planning].*

Brexit was the most commonly discussed challenge amongst the various macroeconomic factors, primarily due to its impact on confidence, exchange rates and trade uncertainties. Most companies have given this detailed thought but only a handful had committed any investment to a contingency plan.

"We have set up entities in Ireland and Germany to protect ourselves from Brexit...we will move services to Ireland if we need an EU HQ..."



■

"We are worried about a further depreciation of Sterling, but we haven't got any hedging in place..."

■

"Our back up plan is to move people to Sweden, but at the moment we are adopting a wait and see approach."

Some noteworthy comments from survey respondents included:

- **Macro factors perceived to be impacting B2C more than B2B companies.** Respondents noted a general lack of confidence in the economy, which was particularly impacting consumer spending. A respondent in the advertising sector was concerned that this could in turn impact his customers' marketing spend, particularly during the crucial Christmas period.
- **Companies with high foreign costs and Sterling revenue have been impacted by sterling depreciation.** Respondents with material levels of imported inputs are worried by recent depreciation of, and ongoing volatility in, Sterling, such as manufacturers and importers of raw materials such as glass and aluminium. They have sought to manage this via: i) short-term currency hedging; ii) renegotiating with suppliers or passing on higher costs to customers where possible; or iii) growing exports and using international sales channels to match currencies. Conversely and logically, companies with export-led models appear to be benefitting, in part due to Sterling devaluation. Concerns around increasing inflation remain.
- **Foreign workers and skilled talent not incentivised to remain in, or forced to leave, the UK.** Many small companies that rely on foreign workers, especially technology companies employing non-UK developer talent, are concerned about this issue. One fintech company noted that only 10% of their developer workforce is from or educated in the UK and they are worried their workers may not see the UK as an attractive place to work in the long term, which may exacerbate the talent shortages discussed earlier.
- **Signing long-term contracts is increasingly problematic, especially with larger customers.** Respondents noted some larger companies becoming increasingly wary of their procurement commitments given the current economic uncertainty, and are therefore reluctant to enter long-term or multi-year contracts. Furthermore, there was direct anecdotal evidence of large companies seeking 20%+ cost reductions on existing contracts with the stated aim of creating margin protection against future currency depreciation. This feels like a potentially damaging trend for smaller businesses if it is replicated more widely if Sterling falls further.
- **Data protection is an ongoing concern for tech companies.** Interviewees noted that a hard Brexit could put at risk the reciprocal recognition of standards e.g. regarding data protection, that could affect transfers of data. Although the UK has implemented GDPR (and other key regulation) alongside other EU countries, respondents were concerned about EU discrimination against UK based businesses post-Brexit. Certain UK

interviewees with European customers expressed a preference for data to be stored in Europe rather than the UK.

- **Small businesses lack sufficient scale to make contingency plans.** Establishing overseas locations to hedge against possible macro risks, such as currency and regulatory location, was cited as prohibitive. Most surveyed companies had some form of loose contingency plan, but generally had not incurred professional fees to execute against those plans. It is interesting to note that none of the companies voiced expectations of a positive impact from Brexit.

IV. BUSINESS SCALING / CUSTOMER ACQUISITION

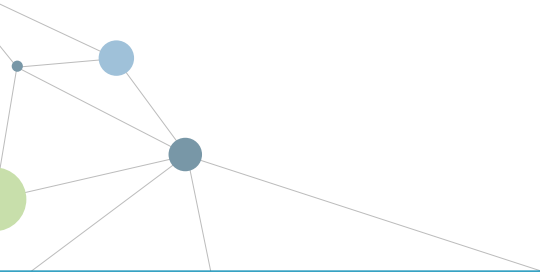
Summary: *Many companies are prioritising growth and finding challenges in selling a disruptive product/service offering.*

Maybe unsurprisingly given the survey's focus on growth companies, for many respondents business scaling is a significant focus for management. Product adoption amongst prospective customers is a key issue for more disruptive market entrants, where companies must both educate their customer and then execute on sales. Interviewees facing these challenges talked about mitigating this challenge by: i) engaging with more senior contacts with prospective customers, especially where their product could result in automation of business processes and therefore job losses; and ii) identifying prospective customers that are more open to investment in new technologies.

Even for more established companies, business scaling remains a challenge to our respondents. Interviewees identified the importance of prioritising routes to growth, particularly in the context of limited capital availability. One company found that it was dominant in a certain sector, and while further investment would have resulted in customer satisfaction increasing even further, the return on that investment would be significantly lower than if it had prioritised growth in new sectors. Even though their customers often ask for additional product features and improvements, management chose to focus on new routes to growth as their strategic priority.

Another interviewee also highlighted the importance of consistently investing in marketing and sales when scaling to continually grow customer awareness, until such point that a product becomes a de-facto winner in its segment, and barriers to customer adoption reduce greatly. This inflection point provides excellent market opportunity but requires significant belief in product quality and the existence of addressable market demand.

Lastly, several interviewees expressed a strategic focus on recurring revenues at the expense of foregoing lower-quality revenues, and shortening their sales cycle in order to scale and maximise their return on customer acquisition costs.



V. GOVERNMENT POLICY / TAX / REGULATION

Summary: *Echoing a view currently expressed more strongly in the retail sector, many respondents felt that business rates detracted from entrepreneurship and created a cash drain in companies with limited resources.*

Some concerns raised over taxation included:

- **Business Rates:** Several companies, especially those that are pre-profit, discussed the onerous and regressive impact of business rates. This creates a significant challenge to companies requiring large premises, or to those for whom locating in London is key to attracting customers/staff. Many felt that business rates detracted from entrepreneurship and creates a cash drain

in companies with limited resources. One interviewee reported pressure to progress products quickly from R&D into revenue generation.

- **Taxes on employment:** A few interviewees felt it was incumbent on the government to reduce taxes on incremental employment e.g. National Insurance contributions, and to simplify the tax regime to encourage more entrepreneurial activity e.g. tax breaks when issuing shares to employees.
- **IR 35 Tax Policy for Contract Workers:** A payroll outsourcing company raised contractor legislation, which has clear implications for our respondents. IR35 may exacerbate skilled labour shortages. For example, the aforementioned developer shortage in the UK is perceived to be largely filled by foreign workers. A material change to their tax position, in addition to (perceived) concerns around immigration status, could drive these workers overseas.

"We are looking at taking 10,000 ft² of office space in central London – and rates would be over two thirds of the rental cost. This is just a tax on businesses regardless of their profit"

"Business rates increases have become ridiculous...they are a cost we just have to eat and they make no sense at all..."

Two areas of governmental support were identified by interviewees. The Department of International Trade's Overseas Market Introduction Service (OMIS) was credited with assisting one of our respondents in finding a Spanish distributor for their product. Tax credits were also identified as a valued government policy. However both of these initiatives, whilst well received, were criticised for being poorly publicised and thus underutilised by their intended beneficiaries.

VI. INFRASTRUCTURE AND/OR SYSTEMS FOR GROWTH

Summary: *Implementing business systems and processes assume increasing importance as companies seek to scale, but experience is mixed.*

Respondents reported product quality and customer experience as being key focuses for very small companies, whilst business systems and processes are often a secondary concern. These however assume increasing importance as a company seeks to scale. One interviewee noted that their company reached a few million pounds in revenue relatively quickly, but had poor systems in place and lacked the ability to make data-driven decisions. They spent approximately nine months in a thorough system identification and selection process, and implemented a suite of off-the-shelf and in-house software systems. Whilst system implementation took a few months longer than expected, and the project closed 10% over budget, the improvement in decision-making has proved invaluable.

Another respondent – a manufacturing business - discussed procuring expensive systems for stock forecasting and managing online orders, but employees did not adopt them due to difficulty of use. Management were focused on growth and did not initially drive usage of these systems. They are now looking at how to optimise the systems in order to provide more relevant data, and are re-focusing on monitoring employee usage in order to drive adoption and productivity improvements.

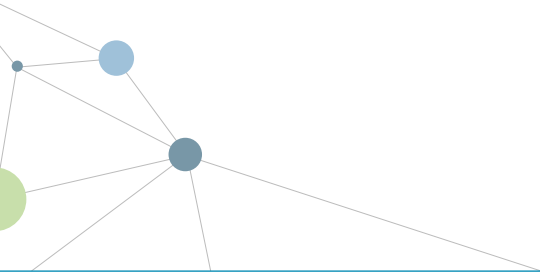
VII. COMPETITION

Summary: *Competition can be more welcome than might be imagined.*

Respondents noted that it was important to understand points of competitive differentiation in order to sell effectively to customers. One manufacturing company found that customers were making comparisons between their product and cheaper overseas alternatives, and often ignored their superior quality and service provision. This company decided to offer a range of production solutions (the UK, Eastern Europe and Asia), with concordant pricing structures and service provision, so that both cost-conscious and service-conscious customers could be addressed.

Some respondents made a slightly surprising observation that competition is not always a negative for them, to the extent it focuses employees on key corporate targets. Competition may, for example, help to maintain focus on optimising cost structures. Respondents identified streamlining production processes across product lines, automation of customer service and order management, and outsourcing certain functions such as payroll and finance as areas of focus.

Some interviewees noted that they had no clear competition due to the disruptive nature of their product. These companies focused on the need for continual product innovation to maintain this advantage. One interviewee's company had been acquired by a larger corporate entity, which underinvested in the acquired product set causing erosion of competitive advantage. The acquirer eventually replaced the CEO and was forced into a turnaround due to underinvestment.



VIII. WORKING CAPITAL TERMS WITH KEY CUSTOMERS / SUPPLIERS

Summary: *The problems of late payment to smaller suppliers have been well known for many years – it was raised here but with a relatively low ranking.*

Several companies identified that funding large contracts or long payment terms is an issue. Smaller companies generally noted a lack of negotiating power when selling to large customers. Companies generally recognised the importance of this area and identified the following actions they take to manage cash flow:

- **Request advance payments from customers:** One interviewee noted that advance customer payments was their most significant source of funding; this appears particularly relevant once longstanding customer relationships have been established.
- **Maintain strong relationships/loyalty with suppliers and customers:** One interviewee noted that whilst larger companies have a reputation for paying suppliers late, in our interviewee's experience this was not the case as long as frequent dialogue and a good working relationship was maintained with the customer.

IX. BARRIERS TO DOMESTIC AND INTERNATIONAL GROWTH

Summary: *Property costs remain top of mind, and distributor relationships are also seen as an issue by many.*

A barrier to domestic growth that stood out in several conversations was availability and affordability of office space, especially in London. Companies located in desirable or fashionable areas - such as Kings Cross and Shoreditch in London - have found that in many cases their rents have become disproportionate to their cost base. Pre-profit, cash constrained companies noted the burden of a 6 month rent deposit, in addition to dilapidations at the end of a lease. Furthermore, given the typical length of leases and rental contracts - typically signed for the medium to long-term - fast-growing companies find it difficult to anticipate future office space requirements. One interviewee was able to circumvent this problem by using a shared office space provider, charged on a per desk basis that can scale with a growing company.

A few interviewees also discussed challenges to international growth:

- **Using a distributor versus expanding sales teams:** There were mixed reviews on the effectiveness of distributors. One technology company chose to hire UK salespeople to focus on international sales. While this approach has worked for them to date, they note there are certain countries that place greater importance on face-to-face interaction and may require a direct sales team. Some companies viewed distributors and resellers very favourably because opening offices internationally might overstretch

the company, especially in remote geographies. Distributors may facilitate quicker international expansion, albeit at the expense of loss of control of customer relationships. One respondent noted that regulation can be burdensome in Latin America, but their distributors had greatly simplified their go to market.

- **Global Taxation/Regulations:** Respondents noted difficulty in complying with myriad regulatory and taxation regimes across borders. One respondent, a digital technology company, sells its products in over 100 countries and noted difficulty in tracking government regulation. More developed countries such as the US have also proved challenging given differing tax regimes across states. Companies broadly recognised the importance of specialist advice and noted that local tax and accounting firms often provide a cost-effective solution.

Aside from tax legislation, further regulations such as health and safety provide an incremental burden. One interviewee using adhesive in their end product was forced into a product recall due to new EU regulation of that adhesive.

- **Foreign exchange currencies:** Many respondents accepted Euros and US Dollars from customers through payment platforms, converting to sterling at spot rates. Some interviewees with significant foreign currency exposure worked with brokers to put in place hedging arrangements for pre-contracted revenues. Some companies importing raw materials from overseas also reported hedging. Many, however, did not note any specific management of their FX risk.

X. RESEARCH & DEVELOPMENT

Summary: *Good news for the UK government: all the companies that conducted R&D noted that the tax credits are a strong incentive.*

R&D was not frequently cited by respondents as a major concern. Many were more focused on monetising existing products. A few interviewees noted the challenge in balancing investment versus shareholder returns, and that convincing shareholders of the importance of R&D to future returns is key. All the companies that conducted R&D noted that the tax credits are a strong incentive.



Appendix A

About the author

Sohail Jain graduated with a Masters in Business Administration (MBA) from Cambridge Judge Business School in September 2018. His background is in banking having worked in Canada and the UK with CIBC World Markets.

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About FPE Capital

[FPE Website](#)

FPE Capital is an established private equity investor into high growth UK smaller private companies. It has recently raised a new fund, FPE Fund II LP, of £101 million to accelerate this investment strategy. The team is headed by co-Managing Partners David Barbour and Henry Sallitt. FPE's core investment focus is into asset light business services sectors, with a particular focus on software, connectivity and technology-enabled services. Recent successful investments include card payment technology player Creditcall, money transfer

business Small World and ticketing software developer Ticketscript.

Investors in the firm's most recent fund include large US, UK and European institutions together with over 50 high net worth entrepreneurs and business leaders. The focus is to back growth plans in smaller UK companies both with new capital but, as importantly, with expertise and experience in scaling smaller companies as they enter a new stage of growth.

Further information is available on FPE's website. www.fpecapital.com

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Appendix B

Secondary Research Sources

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2. Barclays, 2017. The Barclays Business Sentiment Survey.
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5. Institute for Public Policy Research, 2017. Equitable Equity - Increasing and diversifying finance for high-growth SME's in the UK's regions.
6. Centre for Responsible Banking & Finance - University of St Andrews, 2016. The future of funding for small and medium sized enterprises in the UK.
7. Barclays, 2018. Unlocking growth – How data can help your business get into shape for expansion.

Appendix C

Questions used during the interviews

1. HR Questions:

- a. Could you describe your biggest challenges with human capital (hiring, retention, pay, productivity or motivation)?
- b. What kinds of skills do you find it hardest to recruit for in the UK? Do you find it harder to find quality overseas recruits?
- c. Have you historically outsourced roles / functions – and what were the drivers for you to do so (cost, quality, other)?

2. What are your key R&D priorities? What are your biggest challenges to monetising new products?

3. R&D:

- a. What government initiatives / support do you make use of when it comes to R&D?
- b. Do you consider the level of support adequate? What else do you suggest the government can do to encourage R&D?
- c. Is finding the right skilled employees a major R&D consideration for you?

4. How competitive is your market?

What do you think are key factors to you losing versus competitors when you do – scale, product quality, ability to win on price, ability to support customers, etc.?

5. How do you expect future changes in trade regulation (tariffs, quotas, trade agreements, etc.) to impact your business, whether these are recent or future related to Brexit?

6. Is FX volatility a concern for you – how do you manage FX risks? Natural hedging, derivatives, etc.?

7. Are there any further relevant laws and regulations which impact your business and operations significantly? (related to taxes, consumer protection, labor laws, etc.)?

8. Do you expect your company to require funding in the next 18 months? If so will it be for:

- a. Working capital requirements: How easy is it to obtain working capital financing? What is your view on pricing (cheap vs expensive)? Have there been any particular changes in supplier/

customer behaviour which have driven a WC requirement?

b. Growth purposes: how do you think about your capital strategy (Debt vs Primary vs Secondary funding)?

9. Are you expecting to grow your international presence in the next two years (if applicable)?

a. Into Europe: how will this be impacted by Brexit and the uncertainty around ongoing negotiations?

b. Globally: What are your key/target geographies, and what are the challenges that specifically face you in each of them?

c. Have you ever tried & failed to grow internationally? What were the key issues you faced? How did you approach internationalisation (direct vs channel, new hires vs repatriate current employees, etc.)



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