

Brexit and its business impact

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How scale-up business can meet Brexit challenges

This special Brexit report examines how UK entrepreneurs and scale-up businesses have been affected by the EU referendum over the past 12 months.

Our Study analyses what steps these businesses are taking to respond to difficulties and uncertainty in the market, while simultaneously predicting what challenges and opportunities await the scale-up business community.

We surveyed over 1,100 entrepreneurs and scale-up leaders over the past twelve months to map their confidence in their business and the economy.

The research focuses on a range of subjects, covering macro problems such as whether the UK economy might improve and if the government was truly supportive of private enterprise.

Our research drilled down to the specific issues affecting scale-up businesses, including whether the respondent's business was looking to increase headcount or if their appetite to borrowing had changed in the recent past.

These questions allowed us to get to the core concerns of UK entrepreneurs and scale-up business leaders, as well as helping them navigate these difficult times.

The results were encouraging: the entrepreneurial, and scale-up, community are apparently trying to shake off the negative effects of Brexit.

Fears linger around access to funding but, largely, Britain's businesses exude an air of confidence. Come what may, most scale-ups will not put their plans on hold and are looking to expand.

Scale-up Report 2014:

By developing scale-up businesses we will secure significant economic value and the competitive advantage of Britain for generations to come:

- In the short-term, analysis suggests an additional 238,000 jobs and £38 billion additional turnover is possible within three years of reversing the scale-up gap.
- In the medium-term, research shows a possible boost of £96 billion per annum is possible.
- Long-term analysis shows a potential of £225 billion additional gross value added and 150,000 net jobs by 2034.

Brexit bringing a boost to scale-ups

Government beginning to regain confidence in fast growth businesses

Scale-up belief in government support may begin trending upwards, despite uncertainty, as measures taken over the past year start to take effect.

Belief in government support reached a low point in March, coinciding with the triggering of Article 50, with only four out of ten respondents believing that the government was acting in their best interests.

However, the government appears to be regaining the confidence of entrepreneurs and scale-up businesses: there are indications that the government has begun to recognise the importance of scale-up businesses and what they can bring to the UK economy.

Just a year after the Referendum, the belief that policy is supportive of private enterprise has begun trending upwards with nearly 50% of respondents believing they have the support of Theresa May.

Government initiatives not just lip service

Since the beginning of 2017, several initiatives have been launched to transform the start-up ecosystem into a scale-up one, by encouraging (and supporting) high-growth businesses. The appointment of a scale-up champion, a government minister who will promote their value, was supplemented with the development of a taskforce.

Crucially, other government departments are buying in to the benefits that scale-up businesses can bring.

Philip Hammond announced the launch of the Patient Capital Review at the Autumn Statement 2016, and a major consultation on financing growth in innovative firms began in August 2017. These changes are indicative of a government intent on promoting scale-up business and not just paying lip service to the idea.

Is current government policy supportive of scale-ups post-Brexit?

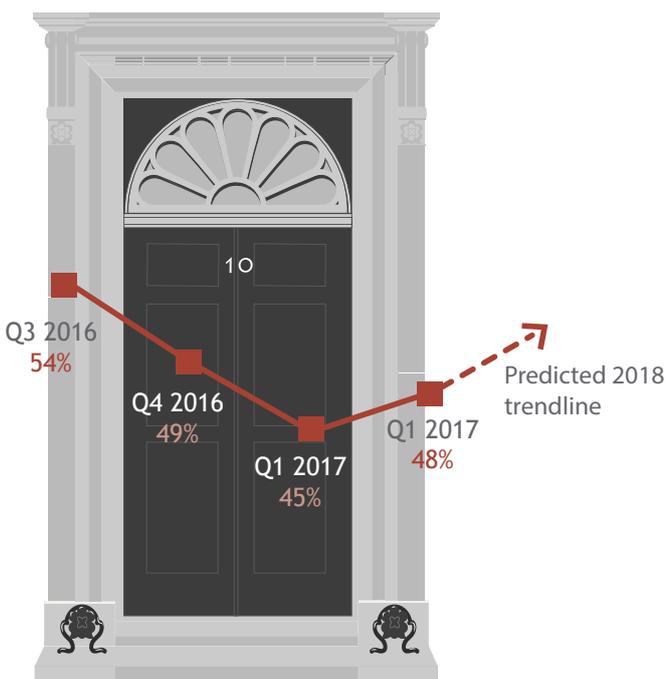
How can the government help?

Britain needs to take its thriving entrepreneurial community seriously and encourage growth - and yet, despite the huge push to entice individuals to set up a business, there has been a failure to assist those businesses to grow.

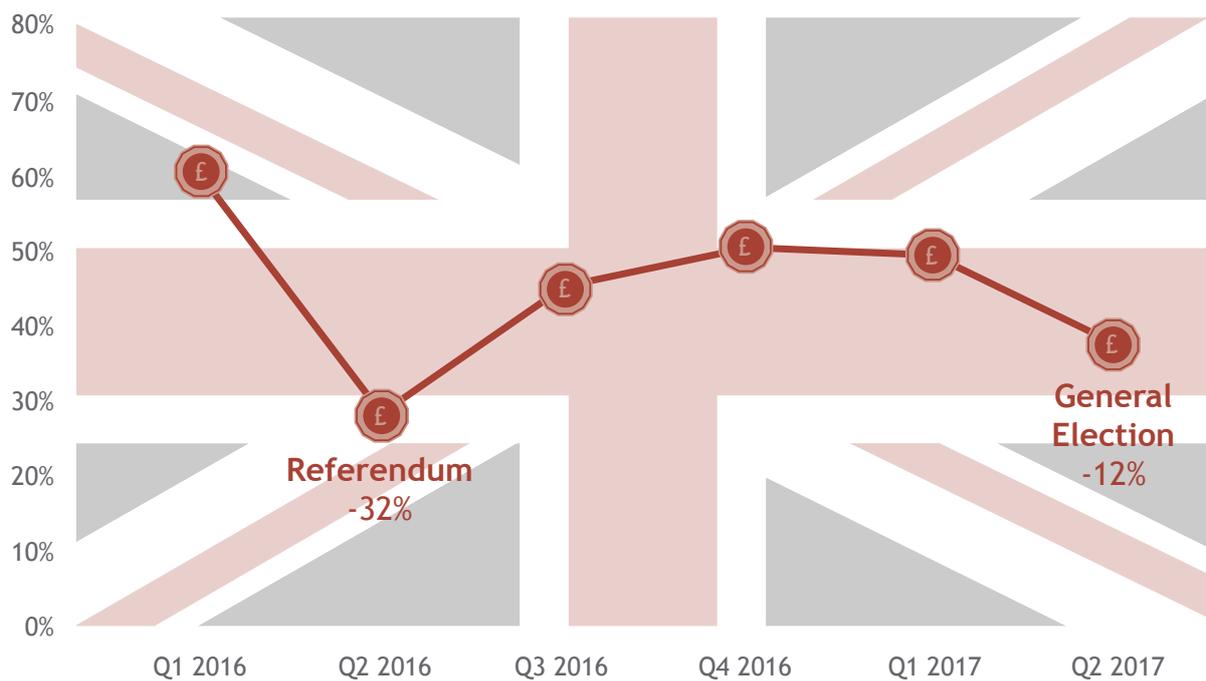
As a result, many start-ups have been left searching for information on what to do when they reach a certain level. If the UK wants to benefit from the scale-up revolution it needs to improve the failure rate of start-ups and better support those with high potential.

One area the government should begin to look at is the funding of Local Enterprise Partnerships (LEPs), which are currently under-funded and are dependent on assistance from private bodies.

Adequate funding for LEPs could see them develop local ecosystems, thereby bringing material change to the local, and wider UK, economy. Better central funding should come with accountability, which can ensure that the taxpayer retains bang for their buck from the LEPs.



Do you expect the UK economy to improve in the next 12 months?



Wider economic concerns benefiting scale-ups

Although suffering a massive 30 point drop following the vote to leave the EU, respondents' belief that the economy would improve had largely recovered prior to the General Election, with over half predicting growth in the UK economy over the coming year.

The anti-big business rhetoric on the campaign trail shone a positive light on the smaller/medium end of the business community, as both parties looked to promote the sector as crucial to the success of the UK economy.

Confidence in the economy, from a SME perspective, could hopefully continue to trend upwards in the next 6-12 months, providing no further unexpected shocks occur.

The vote to leave the EU, and subsequent General Election, has had a polarizing effect. It has created widespread uncertainty and yet, at the same time, the ideal environment for Britain's small and medium-sized businesses to develop: positive public perception, a supportive government and an economic need to find ways to encourage growth.

Innovation key to funding post-Brexit Britain

Access to funding and interest in borrowing is at a low - but is anxiety overshadowing a receptive market?

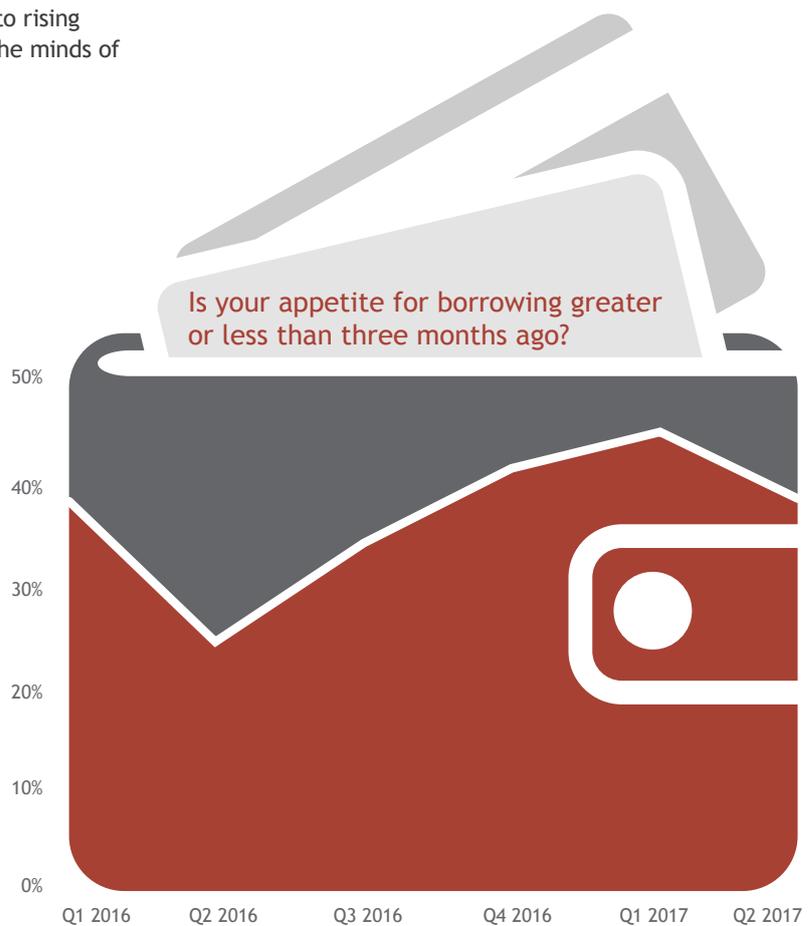
Scale-up businesses have little interest in borrowing and believe that funding is in short supply.

Our research shows that entrepreneurs have low confidence in finding the funding they need since the referendum vote, with 41% of respondents believing that access to funding is improving and only 37% looking to borrow over that period.

Perception vs. Reality

The dampening of the market appears to be more expectation of problems ahead rather than reality of available finance right now. The uncertainty of Brexit, coupled with a tumultuous political system to rising inflation is likely to be weighing heavily on the minds of many business leaders.

Anecdotal evidence is indicating that there is money there for the right business, with CityAM recently highlighting that businesses are looking at a near record year for the M&A market. Ultimately, businesses are still looking to scale up but are less confident in the world around them and the ability of financial institutions to support them. However, there are so many alternative forms of finance available that the right business with the right story can still achieve successful rounds of investment.



Innovative funding for innovative businesses

Research indicates that scale-ups are changing tack, increasingly using external finance and business funding to grow rather than just sell. While many still use traditional forms of financing, entrepreneurs are keen to explore new sources.

Conversely, our own findings show that entrepreneurs are currently not confident about sourcing this funding. This is a problem; scale-ups have already shown their capacity to generate jobs and growth and, on a larger scale, to support the health and strength of the UK economy. If scale-ups do not receive this support, it is likely that our economy will suffer, as growth dries up and talent moves away from the UK.

More needs to be done to help scale-ups: to support them in making the decisions they need to grow, and in finding the financing they need to realise their plans. This may require new and innovative forms of funding to be created following the Patient Capital Review, such as regulated crowdfunding.

However, simply ensuring that business leaders remain aware of the traditional areas of funding open to them, and the benefits, costs and consequences from using them, could develop the scale-up ecosystem.

Funding: fight the fear

It is vital that entrepreneurs and business leaders take emotion out of their business decision-making process. Irrational uncertainty and fear should be kept to one side, scale-up leaders need to analyse potential business growth using the concrete information available to them.

Access to funding may be perceived to be harder at present; currently only a third of business leaders believe adequate funds are available. On the other hand, anecdotal evidence, from our corporate finance and investment management teams, indicate the market has large numbers of individuals and institutions looking to invest in high growth companies.

In this environment, quality is key to accessing funding, particularly in terms of the business pitch and its long term prospects. Funding is available for high potential businesses.

On a human level, it is understandable: early stage businesses are potentially more liable to market shifts which can be accentuated by Brexit and they may want to wait and take stock before making any funding decisions. However, businesses in a growth cycle will not be able to stay still for long and should take a long term view; Brexit should not stop entrepreneurs looking for funding.

Scale-ups looking to build but lacking the blocks

Entrepreneurial ambitions not dented by Brexit, but access to talent is an increasing concern

Entrepreneurs remain confident in growing their own business, although they are increasingly unsure of finding the right people for the job.

Our research shows that entrepreneurial businesses remain ambitious about their potential to grow, with just under 60% expecting to increase headcount- a result that has not been affected by Brexit.

However, there is growing concern about the relative readiness of potential employees: only 32% believe that the employment pool is adequately trained. The steadily downward trend on this score does not bode well for ambitious, fast growth businesses.

The broad message from our research is that entrepreneurs are resilient - their ambitions are still high and have not been hugely affected by Brexit. The market has become used to absorbing change, from regulatory crosswinds to political and macroeconomic upheaval, in the UK and the wider world. Although these changes can have an impact on the day-to-day management of a business, has not poured cold water on entrepreneurial growth plans.

Nonetheless, one of the most reported impacts of Brexit is movement of labour. Entrepreneurs seem to recognise that a consequence of restricted movement of labour will be a potential reduction in access to the talent required to build their business.

As it stands, without ready access to talent, including talent outside of Europe, British business will be negatively impacted.

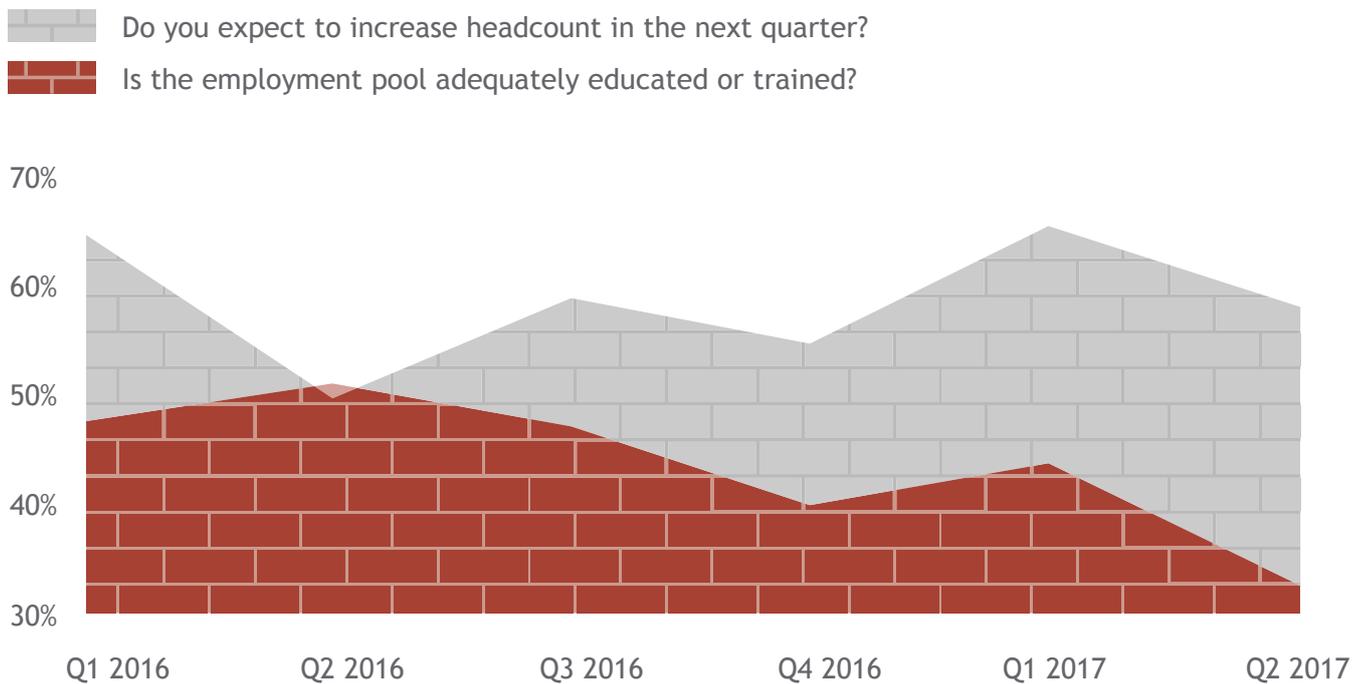
Skill shortages: a growing issue

One of the most significant issues for scale-up companies remains skill shortages, according to the ScaleUp Institute, a private non-profit company that identified six main gaps as to why businesses struggle to scale in the UK. Our own research supports this, validating the prediction that within the next year, only 20% of business leaders believe there will be enough appropriate, relevant and qualified talent in the workplace. It's unclear whether the employment pool itself has shrunk, or whether the existing workforce lacks the skills and training required to be successful in a scale-up business.

One reason scale-ups go to the EU for talent is a lack of confidence in the local employment pool; entrepreneurs do not feel that the national workforce is adequately training people to move into business. The government could provide real support at this stage: not only by creating a scale-up visa, enabling talent to enter the UK regardless of the impact of Brexit, but also by supporting the appropriate training of our home-grown talent. Arguably, training our school leavers and students for the world of work will be crucial to British businesses in the long run - regardless of the impact of Brexit.

 Businesses need employees who are adequately trained - but because of Brexit, entrepreneurs are not sure that those people will be available to them. 

Growth: potential vs. preparedness



The Brexit paradox

One interpretation of our results focuses on the paradox of Brexit. In order for scale-up businesses to expand despite Brexit, businesses need employees who are adequately trained - but because of Brexit, entrepreneurs are not sure that those people will be available to them.

In other words, ambition is what drives entrepreneurs - but access to the workforce they need to fulfil that ambition is by no means guaranteed.

If fewer workers enter the UK, businesses should look more closely at their existing employees, assessing whether there is talent available that can be further developed and trained to provide the skills required. It is advisable for firms to begin this process now rather than waiting for the final shape of the Brexit deal to emerge.

European competition not impacting UK confidence

Business is booming, despite Brexit uncertainty, according to entrepreneurs and scale-up leaders. Nearly 80% of respondents are planning for growth over the next twelve months, despite the looming March deadline.

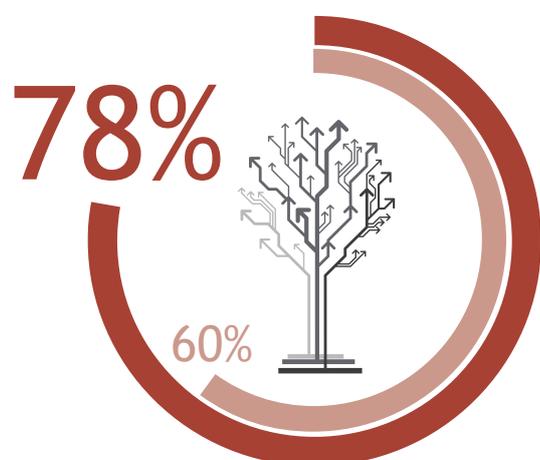
81% of our respondents say that they weren't affected by the Article 50 uncertainty, demonstrating the ongoing resilience, and confidence, of the UK entrepreneur.

The market still strong

The immediate reaction, following the EU referendum vote, was a massive depreciation in the value of the pound. Larger businesses tend to hedge out risk, and therefore are less effected by currency fluctuations, but smaller businesses, who are less likely to hedge out currency risk are much exposed to the both the negative and positive risks of currency fluctuations.

Increasingly, smaller businesses are now international and so have income and expenditure in several currencies.

Are you planning for growth in the next 12 months?



- Q2 2017
- Q2 2016 (post-referendum)

It was feared that investment would begin to dry up as the market declined. However, while business owners and investors may be slightly less confident they are still, by and large, eager to see what the future will bring. The UK offers an ideal situation to begin a business and scale a business:

- GMT allows business to trade and communicate easily across the world
- The rule of law remains paramount
- There are a number of tax efficient savings to assist in growing a business
- There is a developed professional sector to support a business
- There is access to huge supply of technically proficient individuals

All the above factors, which make the UK a great place to start a business, also make it ideal for businesses seeking investment.

New Competition = No problem

The other, less heralded, issue with leaving the EU was its potential tarnishing of Britain as a place to do business - and the injection of confidence to other capital cities who may find themselves more able to compete with London.

Paris has recently launched Station F, a centre dedicated to start-ups, Berlin is looking to attract finance and a host of other European cities now seek to interest the highly-skilled workforce that is a requirement for all scale-up businesses.

However, what has become apparent is that few of these cities lack the rounded appeal the UK offers. The social aspects of the UK, such as schooling, culture, law, among others, are still ahead of its European counterparts - while the infrastructure available to those starting and scaling-up in the UK remains second to none.

Indeed our respondent's confidence in their own prospects over the next year is only likely to increase.

Britain, still the business

The UK scale-up market is flourishing, partly due to the external finance available to many within the sector. From angel investors to private equity, there are advantages in getting scale-up investment from the UK.

The number of private equity deals has been steadily increasing in recent years. Arguably, if Brexit was an issue in the UK market then businesses looking to raise external finance would find it a lot harder than they are currently.

There have been several Series A to C investments (the different rounds of investment that a business goes through) into scale-up companies in the UK in recent months. As these represent a confidence in a company's long term growth, it is hard to argue that investment is shying away from backing the UK as a place to grow a business.

It is generally sensible for an entrepreneur to at least consider "de-risking" their personal position by taking some cash out of a business as part of a private equity deal.

This allows them to begin solidifying their financial position while still having a significant proportion of their work personal capital aligned with the success of the business.

A few years ago, the trend was for an entrepreneur to sell the business entirely and start again. However, following the course of fast-growth businesses in the US, we're now seeing a noticeable shift to individuals remaining committed to scaling-up their business by either retaining senior positions or large equity stakes.



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New frontiers beckon for post-Brexit business

Companies looking to thrive must think further ahead than just March 2019

It is clear from our research that entrepreneurs and scale-ups that do export are confident of increasing turnover, although there are some concerns about the financial health of non-UK trading partners.

However, it's not just Brexit that business needs to be aware of. As the world becomes smaller, in trading terms, then all businesses need to start planning for the future. Any entrepreneur, and their business, needs to be adaptable and nimble enough to survive any short-term business and economic impacts.

Would-be exporters unconvinced

The Office of National Statistics reported in July that the trade deficit widened to £8.9bn in Q2 2017, thanks to an increase in imports and a decrease in exports.

Our research suggests that the government is failing to get the message across: it is neither persuading the public that it wants to encourage businesses to expand overseas nor that Britain is open for business.

A reason why government is failing to convince domestic companies to become exporters is the perceived roadblocks in their way.

These hurdles can include a lack of access to market information, a shortage of international touchpoints, insufficient access to finance and an unclear understanding of the role that companies play in their respective supply chains.

Relocation, relocation, relocation

In advance of whatever Brexit may look like, companies have already started planning for their future.

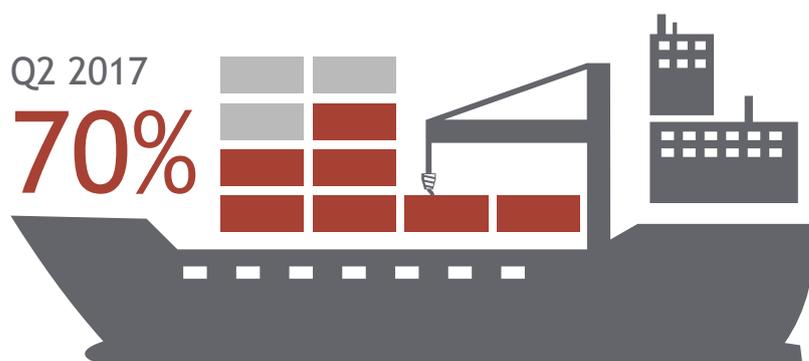
International businesses looking to relocate staff to new centres (European and further afield) have set this planning in motion, as personal issues come to the fore.

The school year starts in September; for any executive looking to move in 2018, planning has to start over the next month or two. The decision to move a family is not an overnight process. Companies hoping to keep hold of their executives need to have relocation in mind now.

The same is true for businesses and their clients. There may be a need to shift more business to Europe, to find ways to innovate in order to hold on to current clients and generate new sources of revenue.

Every business looking to survive in the short term must have international expansion on their mind, regardless of Brexit. It may not be appropriate for all but it needs to be considered before it is too late.

If your business exports, do you expect your turnover to increase in the next 12 months?





International markets: staying alive

If the short term need is for companies to relocate in order to avoid falling foul of Brexit, the medium term requirement is no less urgent. Quite simply, British businesses need to remain relevant to both domestic and international customers; they can do this by identifying the need in other markets and shifting what they offer to match this need.

There is a danger that British companies might focus excessively on the immediate impact of Brexit and ignore other, arguably, more global factors. President Trump's protectionist policies and their impact on global trade are a far greater concern to many.

Closer to home, Europe seems to have regrouped after the initial Brexit shock and pressure, though broader risks remain; the forthcoming elections in Europe will be the latest test of regional stability.

Brexit - just another bump in the road?

Looking further ahead, the very shape of business is changing. Disruption, both a buzzword and a threat, is now becoming the norm; companies driven by innovation are having a dramatic effect on how businesses achieve their growth.

For example, in the context of changing legislation, favouring the development of alternatives to diesel engines, Tesla's expansion in Europe probably poses a much more serious long term threat to German automotive trade than Brexit does.

Faced with disruptive innovation, uncomfortable choices are becoming more apparent. Should companies adapt their business to supply more components to international markets, or should they investigate ways in which to support and be a part of innovation?

It is clear that scale-ups and smaller businesses looking to survive in the post-Brexit world should find ways to avoid or manage the seemingly inevitable bump in the road. A longer term view is required.

For more information

If you're an owner-manager, entrepreneur, adviser, or if you work with a scale-up business, we'd love to hear from you! Please speak to your existing Smith & Williamson contact or contact our team to discuss how we can help.

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