What Welsh Companies Say: Growth Prospects

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Hodge Project Preliminary Survey Results

As part of Hodge project into growth prospects and obstacles for Welsh companies we conducted a survey and a number of structured interviews. We invited 100 companies to complete a questionnaire and interviewed another fifteen. There was a 21 per cent response rate to the survey, which was aimed at companies enjoying rapid growth or in growth sectors. Those interviewed include three companies that the Welsh government regards as anchor companies but the others were generally smaller and less established. They were selected with a bias to those which seemed to have good prospects for selling outside Wales and were located in South Wales in either the Cardiff or Swansea City Region.

A summary table of results is at the end of this document. With a sample this small, findings are as much anecdotal as representative. Some of the anecdotes, however, are telling and one of the findings is so general in the sample that it may be regarded as statistically significant.

The good news from the survey was that 80 per cent of the companies planned to expand in wales during the next five years. We were pleasantly surprised that a relatively small sample turned up a number of companies with a distinctive IP and consequently good growth prospects. The sample showed that neither Rome nor Welsh prosperity was built in a day however; nearly 70 per cent of the companies had been in business in Wales for more than 10 years while six were relatively new, in business for less than five years.

The sample reflected the openness of the Welsh economy. Some 72 per cent said 50 per cent or more of their sales were outside Wales while of those 43 per cent said over 90 per cent of their sales were outside Wales. One or two companies were still at the development stage and had no significant sales. Some companies, such as those in the software sector, had no significant supply chain, their costs being almost entirely labour and rent. Of those with important suppliers, three-quarters of companies said less than 50 per cent of their inputs by value came from within Wales and for 40 per cent of companies that figure dropped to 20 per cent or less. However, one highly successful company in electrical engineering – exceptionally - had made a point of trying to ensure all its important suppliers were Wales-based and it had achieved that relatively easily.

The Biggest Problem – Qualified Staff

When firms were asked for the chief obstacles to growth, the greatest by far was getting qualified staff. 23 companies, 64 per cent of the sample, cited that. If firms offered five suggestions for the biggest constraint (including "other") replied at random we would expect perhaps 7 firms to cite finding personnel. If 23 do so it is highly likely to be a general problem at least for growing companies.

Nineteen per cent cited finance. Though that is not above what you might expect from random responses, those complaining were vociferous and specific about the problems – see below). Just two cited infrastructure concerns, none cited problems with suppliers. Those results may well reflect the sectoral composition of the sample and its geographical location in urban centres in South Wales. Twenty per cent cited other factors, which included planning obstacles, the difficulty of getting adequate premises, lack of support from the Welsh government and from head office outside Wales. Five cited difficulty in getting a big enough share of a competitive market to justify further investment

The difficulty in getting qualified staff occurred across sectors – in engineering, software, finance and the creative sector. The main problem was at the graduate level. Getting shop floor operatives was less of a problem, though it had a sub-regional dimension. Firms south of the M4 or in the lower valleys near the M4 saw no problem finding less-skilled workers (though we have an ultra-small sample because many firms in software or bio-tech did not employ unskilled workers anyway); firms near the heads of the valleys professed a problem getting even unskilled workers who were reliable in attendance and time-keeping (again the sample is very small).

There is a broader issue with the quality of general graduates for middle management and a still bigger problem in finding technical graduates at the right level. Over half the firms cited this as an inhibiting factor on their growth. However, there are exceptions to every rule and one international software firm said a skill base on which to draw was a big attraction to them of being in Wales. They are in a specialised area and it so happens that a local university provides a course which feeds directly into their requirements. Even that firm said that as they grew the supply of qualified graduates was likely to get much tighter. Nonetheless this single instance shows that specialised course provision, anticipating a commercial demand, can be productive for the university and the economy.

The firms which employed post-doctoral graduates for research and development purposes reported much less difficulty in finding that sort of staff. Such firms are generally in a niche area and the work they offer is interesting and attractive to specialists, who are prepared to move to find such work.

Resolving the general problem of skill shortages unfortunately will take time since educational reform and expenditure takes decades to feed through into results. There were two immediate suggestions, however. Heads of incoming firms were impressed with the quality of life in South Wales. Cardiff offered excellent amenities and the outdoor environment and facilities were good too. Yet the impression outsiders had of Wales was that it was a poor post-industrial backwater, which inhibited recruitment from outside. Better marketing and branding of Wales was needed. In the creative industries there was discontent at the throttling back of the budget of the Royal College of Music and Drama, whose graduates were generally instantly employable. That was not understood because much employment in this sector was on contract – the gig economy par excellence – which administrators regarded as inferior to permanent employee status.

Dealing with Government – A Mixed Picture

Only 8 companies had applied for export assistance but a surprising 91 per cent of the sample had sought help from the Welsh government. Welsh business seems highly dependent or focused on public sector assistance. Opinions were equally divided on whether the experience of seeking government help had been satisfactory. Some firms were very complimentary about government support; others found it good but with reservations; yet others were scathing.

Some clear pointers emerged. Firstly, the Welsh government and Finance Wales score higher marks from companies they induced into Wales with support packages than they do from companies already here. A number of potentially important and dynamic companies said they were in Wales largely because of government grants. While there were stresses and strains in arranging the grants they generally reported a satisfactory experience. These firms were found in the finance, software, civil engineering and biotech areas. (How far such inducements will be possible after Brexit is an important issue).

For companies already here the story was less rosy. Indeed, one incoming company having received initial help no longer looked to the public sector, which it criticised for favouring footloose multi-nationals over indigenous or established companies. That risked encouraging purely temporary investments while missing out on real opportunities for further growth. (However the problem is not universal; another company had received initial equity investment from Finance Wales and had no difficulty getting second-round finance from the same source.)

Secondly, a frequent complaint was that the government purported to promote high value added sectors, like advanced manufacturing, yet these created only a small number of jobs. Meanwhile the government's grant procedures were actually strongly geared to direct employment creation; that was a contradiction. An emphasis on direct employment rather than value-added was generally seen as out-dated. One firm with strong IP and third-world markets had outsourced physical production to a third-world country. Nevertheless it wanted Wales to be the centre for research and product development and licensing. Getting financial support or investment from Welsh public institutions had been a tortuous business because the strategy meant much value-added would be in Wales but many "jobs" would not be.

Thirdly, several firms complained about slow, cumbersome, bureaucratic procedures that made it difficult to seize opportunities which required immediate finance. One respondent ascribed this to a lack of commercial skills in government organisations. Another found more flexibility but only at a very senior level while more junior personnel were not responsive. This meant that it was impossible to use public agencies for bridging finance or for working capital. One suggestion was that there should be a cadre of district loan officers who were empowered to extend finance without referring applications up to a committee. They would then be judged on results and audited to avoid corruption.

A separate suggestion for government related to procurement. Several characterised the Welsh public sector as risk-averse in procurement, subject to the "IBM syndrome" and excessively afraid of being seen to favour domestic suppliers. This worked against Welsh companies, especially smaller ones. One software firm cited an instance of seeing a contract for a function where they specialised going outside Wales at five times the price what they would have charged. Others quoted less extreme examples. One firm in the construction sector could get on to the Welsh government's tender list only by going into partnership with a foreign multinational. That multinational always sub-contracted all parts of a project anyway so the indigenous firm did literally all the work on the project but had to remit half the profits abroad. The company was scathing about the suggestion that this was owing to EU regulations, saying that they encountered the opposite discrimination when tendering in France or Germany where domestic companies were openly preferred.

Other Results from the Survey:

There were many fewer complaints about infrastructure than expected. Only two firms mentioned it as a constraint. Several incoming firms cited good communications as being in combination with government grants as the reason for their decision to come to Wales. It should be noted that the only other area of the UK where Tier 1 grants are now available is Cornwall, which clearly suffers from longer and worse communication links than Wales. Broadband connectivity was not mentioned at all, though international studies have shown its importance. However, this result may reflect the bias of the sample to urban South Wales. Elsewhere that is more likely to be a constraint. When prompted, firms in the software sector reported that broadband speeds were now adequate in the Cardiff region having been poor just two or three years ago. They warned, however, that requirements were ever-changing and investment would be necessary to maintain adequacy.

The majority of companies were satisfied with the specialist business services available in Wales. 68 per cent declared local legal and accounting services adequate or better. Others had no specific complaint but used firms outside Wales, often for legacy reasons. The numbers for banking and insurance were slightly lower at 53 per cent and a few respondents expressly said local banking services were adequate unless you wanted to borrow money when the banks proved exceptionally risk averse and demanded unreasonable securities. Small businesses often complain as much but since many of the companies in the sample are successful with impressive growth rates we think the observation probably needs to be taken seriously. There were several horror stories. One company wanted to factor invoices – mainly from large multinational clients who had never defaulted. The bank refused unless the owners provided personal guarantees for the money. At the time the business had an annual turnover of over £2 million.

A couple of firms in highly specialised areas of business noted that while routine legal services in Wales were satisfactory for their specialist requirements they had to go to centres of expertise elsewhere but that was not an issue.

Firms generally tended to regard themselves as unique in the Welsh context. Only a third thought there were other companies like themselves in Wales. Those firms were regarded as competitors and only 3 companies said they collaborated with similar firms. That might suggest that Wales-based companies do not have the appetite or perhaps the opportunity for collaboration and co-operation to win contracts that require more competencies than they have in-house. Several of the more successful firms though cited collaboration with customers to develop the firm's competences and products. In a couple of cases large customers offered joint-ventures or other finance for development.

More firms said they collaborated on R&D - 31 per cent of the sample. There was slightly more collaboration with other commercial companies than with academic institutions. Less than half the commercial collaborations were with other Welsh companies while more than half the academic collaborations were with institutions in Wales.

Reliance on trade associations to help with the business appeared to be sector-dependent. It was important for some 54 per cent overall (19 companies).

Limits to Growth in Wales?

From the in-depth interviews an issue emerged although none of the companies had identified it as a problem – because it is arguably a problem for the Welsh economy though not necessarily for individual business owners. It seemed to us that there is clearly an issue about keeping important IP in Wales. Several research-intensive companies saw that as they grew they would become takeover targets either through a trade sale or after they went public. Indeed, one or two saw no other way to acquire the branding that would open a bigger market up to their products as well as allowing founders to cash out.

That means Wales is rather like a second-division football club with a promising youth development system. As the players come through the best ones are the subject of transfer bids. In most cases they want or need to leave to further their career. If the club is ever to make the Premier League, however, it needs to find a way to keep more of its better players so they can grow and flourish with the club. Similarly Wales needs to keep more companies growing larger in Wales.

The issue is particularly salient because the Welsh government spends money inducing companies into Wales. We encountered companies in software and biotech in Wales because of government grants. The existing management had no desire to leave Wales but saw a trade sale or take-over as highly likely if they were successful. The Welsh government had only a little equity in these companies so the public's bet did not look a particularly good one. The companies could fail to be very successful, as with any venture in an area of rapidly changing technology, in which case the return on public money was meagre. On the other hand, they could be highly successful and get bought out. In that case the possibility that their IP and facilities would leave Wales was real and returns to public spending would be transient. In that sense Wales is in a worse situation than the analogous football club: it is as if the club pays to bring the youngsters into the development system but receives none of the transfer fee when they leave - it all goes to the players themselves.

Admiral insurance was widely cited as a company induced to Wales by a substantial grant, which had remained with a Welsh HQ after going public. However, it is unique in recent years. Meanwhile there are more cases like one indigenous private company we encountered which employs over 800 people and has a turnover of over £300 million. Its half a dozen founders still held all the equity in the company and were all over 65 years old. They did not want to sell but they will have no option if they wish to realise any substantial part of the value of the business. Some of its operations may remain in Wales after a sale but almost certainly a declining proportion after its head-quarters is moved elsewhere.

There is some attention in the press and policy circles to the need for cheaper early-stage finance. Yet there may be an even bigger gap further up the finance ladder where substantial sums may be required either for MBOs or large-scale continuation financing if companies are to be retained in Wales. A requirement for keeping more growth companies in Wales is succession funding or consistent patient finance through the various stages of financing a growth business. There may also be a need for a collaborative effort in marketing Wales and Welsh businesses. The importance of a Welsh "brand", we confess, seemed a rather airy-fairy notion when we began interviews but it recurred as a theme among those business people who, while hard-headed and commercial, attached some value to staying and thriving in Wales.

Evidently both finance and branding require greater commitment of resources than hitherto. The Welsh government has announced a "succession fund" but it totals only £50 million, enough to keep a number of small businesses operating locally but of no use for the kind of larger company cited above.

Similarly we encountered companies who had taken first or second round finance from Finance Wales which had indicated it was looking to exit in three to five years. Where would subsequent financing come from? The answer was London private equity investors. A couple of software companies said this prospect had made them contemplate opening a London office if not moving the business. The scale of resources required makes it difficult for the long-term finance to come from a wholly state-owned institution. It could push the Welsh government "spending" beyond its Departmental Expenditure Limit. There is a need for a substantial private equity investor able to raise and invest hundreds of millions in Welsh businesses *in situ* but one is unlikely to appear.

Profit maximisation is indifferent to place. If IP can be more profitably exploited elsewhere the market will take it there. The wish to retain and develop it in a particular location for the prosperity of that location is a non-market preference or objective. What is required is a commercial organisation able to make money but one that gives weight to that location objective too. So far there are no proposals about how such an organisation could be constituted in Wales.

We would like to end this account with a plea: help us to ensure these results are representative or to modify them where they are not. The questionnaire is on our website. If you run a bona fide business in South Wales, especially one with growth prospects, please complete it online and tell us your experience of what is good and bad about doing business in South Wales.

Summary of Survey Results

Firms who:		**Per Cent**
Sell more than 50 per cent outside Wales		75
Have more than 50 per cent of suppliers by value outside Wales		70
Use business services in Wales and find them generally satisfactory		60
Collaborate on R&D		33
	with other Welsh companies	11
	with Welsh universities	14
Intend to grow in Wales in next 5 years		83
Supply-side obstacles to growth*		
none		22
finance		19
getting qualified staff		64
finding suppliers		0
poor infrastructure		6
other		22
Have sought Welsh government assistance		92
	experience satisfactory	50
	partially or wholly unsatisfactory	42

**Firms could cite more than one obstacle*
Current sample size: 36

N.b. a complete sectoral breakdown of the sample is available only for those companies interviewed. Some responses to the postal questionnaire were anonymous so not all of the respondents can be assigned to a sector.
