Bowmark Entrepreneurs' Index

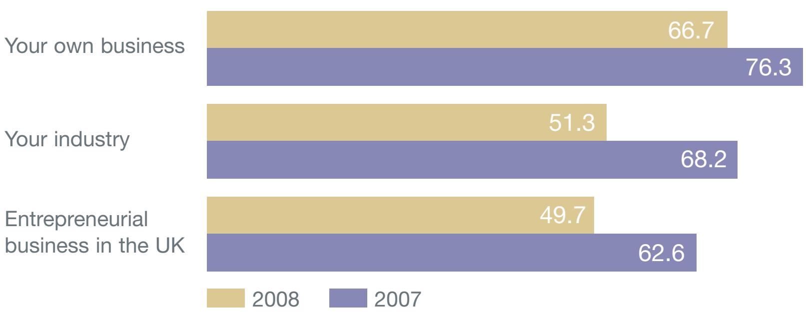
ISSUE 2 - JULY 2008

The mood of small and medium-sized enterprises in the UK has changed dramatically in the past six months, according to the second issue of the Bowmark Entrepreneurs' Index. The Index is a survey of directors of small to medium-sized businesses in the UK. In the wake of the credit crunch and worsening economic outlook, these entrepreneurial bosses have become distinctly gloomy.

Highlights

- the Optimism Index (below), measuring how positive respondents are about their own businesses, has dropped nearly 10 points in six months to 66.7, with an even gloomier mood about their own industries - a near 17 point decline, and entrepreneurial businesses generally - down almost 13 points;
- government intervention and legislation have overtaken skill shortages as the biggest obstacles to growth. Seventy per cent cited these as a burden, up from 56 per cent last time;
- a third of respondents said rising energy prices had a negative impact on their business; and
- around a quarter of companies said the availability and terms of bank debt have worsened in the past six months.

The Optimism Index*



*Index scores are calculated from the average score between 0 and 100 (from strongly disagreeing to strongly agreeing) given by each respondent when asked whether they thought prospects were good for the next 12 months.

BOWMARK CAPITAL

"The outlook for the economy in the next six months is more uncertain than at any time in recent history"

Optimism on the slide

Uncertainty has severely dampened the optimism of small and medium-sized businesses in the UK in the past six months. The Optimism Index (chart on previous page) shows that respondents' confidence about their own businesses has fallen nearly 10 points to 66.7 since our first survey was published in January.

The change in attitude to their own industries' prospects is even more striking - down nearly 17 points to just above 50; while their view on prospects for UK entrepreneurial businesses overall has fallen nearly 13 points to just below 50.

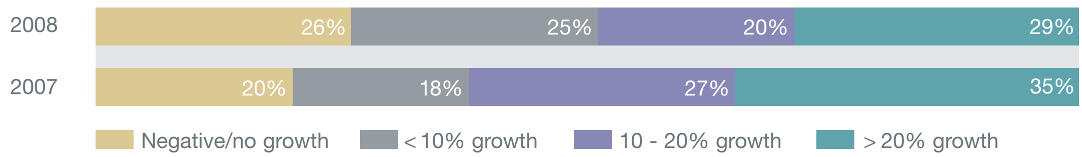
Analysing the findings by sector, publishing and media companies suffered the biggest drop in optimism regarding their own businesses - down nearly 11 points to 65.2. These industries, arguably, are most likely to be hit by corporate belt-tightening. Travel and leisure companies, which are vulnerable to a consumer downturn, experienced a near 10 point fall to 61.7. Healthcare companies, a more defensive sector, showed the smallest decline in optimism about their own businesses - down just 3.6 points to 73.6.

"With merger and acquisition activity likely to be muted in the year ahead, entrepreneurial companies will be concentrating on organic growth"

Performance falters

Performance has slowed in the six months since our first survey. Last time, more than 60 per cent of companies reported profits growth of 10 per cent or above in the previous 12 months. This time, fewer than half experienced 10 per cent+ growth in the past year, and a quarter had stagnant or falling profits, as the chart illustrates.

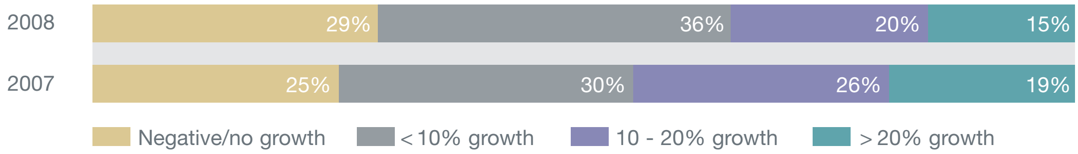
Past performance - profit



Looking at different sectors, travel and leisure firms' profits were hardest hit - just a fifth reported profits up 20 per cent or more compared to a third last time, while 33 per cent said profits were unchanged or lower than a year ago compared to a fifth of respondents last time. Business services companies were the best performers: 42 per cent increased their profits by 20 per cent or more in the past 12 months.

Staffing levels were a casualty of the slowdown for respondents generally. Sixty-five per cent of companies surveyed said staffing levels grew less than 10 per cent in the past year, against 55 per cent last time. Twenty-nine per cent of respondents this time said their headcount was either static or lower. A third or more of manufacturing, travel/leisure, and healthcare companies said staff numbers were unchanged or lower than 12 months ago.

Past performance - employment

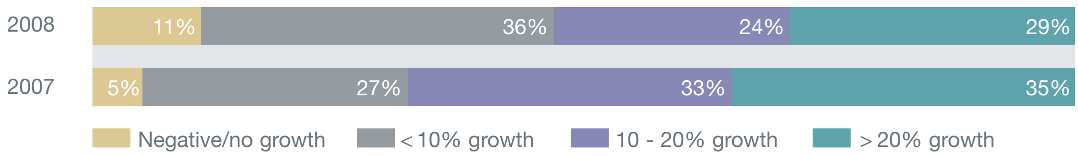


"A real sense of apprehension has set in for businesses dependent on discretionary consumer spending"

Not so great expectations

Entrepreneurial companies are not as positive in their expectations for growth as they were in late 2007 - the optimism they previously expressed has been tempered this time round. As the chart shows, just over half expect revenue to grow by 10 per cent or more in the next 12 months compared with two-thirds in our last survey.

Revenue expectations



Surprisingly, more publishing and media companies than last time expect revenue to grow by more than 20 per cent in the next 12 months (42 per cent v 36 per cent). In contrast, nearly two-thirds of travel and leisure respondents expect revenue to grow by up to 10 per cent, remain static or decline.

While 70 per cent of companies in the first survey expected profits to grow 10 per cent or more in the year ahead, only half of respondents now forecast such a rise.

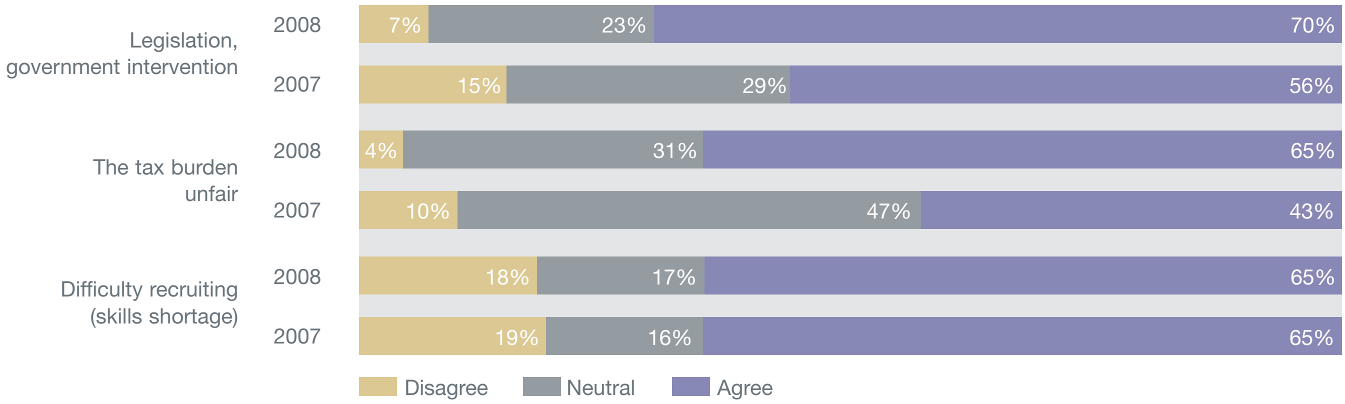
Employment prospects have also worsened. Over a third of companies expect negative or static growth in staffing levels in the year ahead, against a fifth of respondents six months ago. Just a quarter think staff numbers will rise by 10 per cent or more compared to 45 per cent last time.

> "In these difficult times, companies are increasingly sceptical about government red-tape and initiatives"

Burdens getting heavier

The government is failing to support small businesses in these difficult times, our report suggests. Legislation and government intervention have overtaken skills shortages as the biggest obstacle to growth. Seventy per cent rank government initiatives as a burden compared to just 56 per cent last time, as the chart reveals. Travel and leisure companies (80 per cent) and publishing/media and healthcare firms (73 per cent each) were most affected.

Obstacles to growth

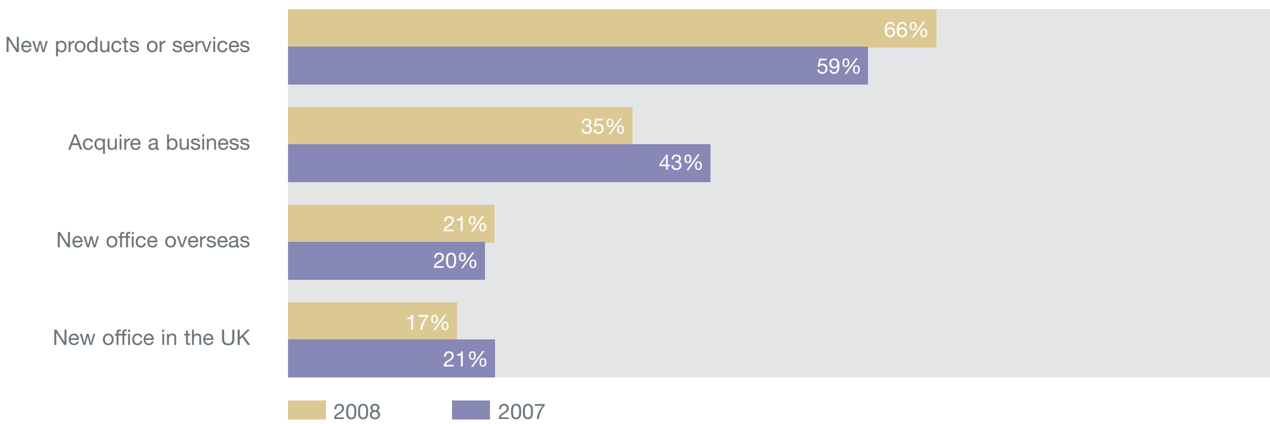


Tax has become a significantly heavier burden for all respondents than previously when 43 per cent cited it as a burden. This time nearly two-thirds rank taxes jointly with skill shortages as major obstacles to growth.

Focus on organic growth

Fewer companies are planning acquisitions - only a third plan to buy a business in the year ahead, down from 43 per cent six months ago, as the chart shows. Instead they are looking to grow their businesses organically. Two-thirds are planning to launch a new product or service, compared to 59 per cent in our previous survey.

Corporate activity

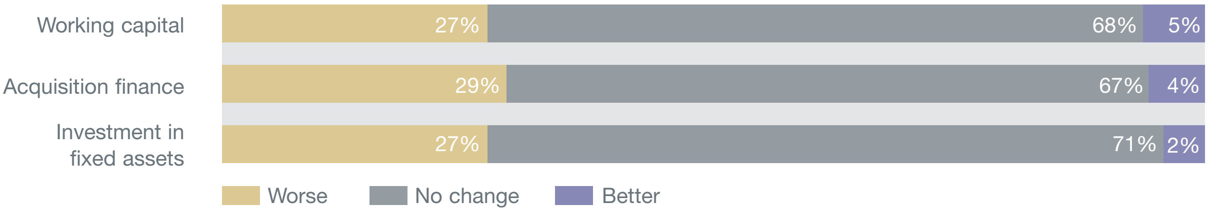


"The credit crunch has had an impact on entrepreneurial companies; but debt is still available, at a price, at the lower end of the market"

Credit crunch: first signs of a squeeze

The biggest impact of the credit crunch on smaller companies in the past six months is that banks have started to tighten the terms on which they provide debt. Twenty-nine per cent of respondents said the terms for debt to fund acquisitions have worsened, while just over a quarter experienced tighter terms for working capital and investment in fixed assets.

Debt: terms



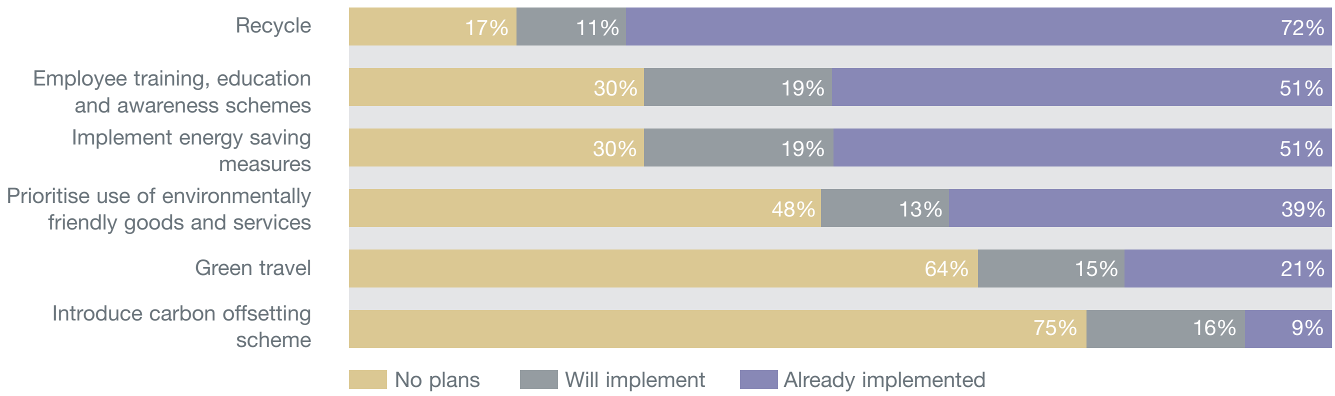
Availability of debt is less of an issue: just over a quarter of respondents found it more difficult to attract acquisition finance or working capital, while a fifth saw a decline in funds available for investment in fixed assets. This was in line with predictions about the availability of debt in our last survey.

However, the companies surveyed still have a strong financial base. Virtually all (98 per cent) were having no problems servicing their debt in spite of the downturn in their optimism, performance and prospects.

Smaller companies actively "green"

Nearly three-quarters of respondents have already put recycling schemes in place, as the chart shows. Seventy per cent either have, or will, implement employee training or awareness schemes and energy saving measures within the next six months. More than a third have, or will, implement green travel and a quarter have, or will, introduce a carbon offsetting scheme.

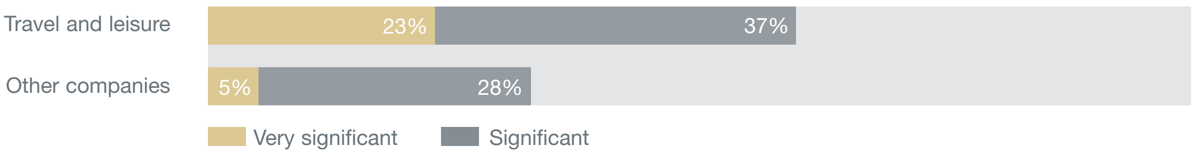
Implementation of green policies



Energy prices take the pleasure out of leisure

Rising fuel prices have hit travel and leisure companies hardest of all the sectors. Sixty per cent of these firms said that higher energy prices were having a negative impact on their business. Just a third of companies operating in other sectors experienced a similar effect. Rising raw material costs had a negative impact on 69 per cent of manufacturing companies surveyed.

Negative impact of rising fuel prices



The Bowmark Entrepreneurs' Index

The Bowmark Entrepreneurs' Index tracks: how positive directors are about prospects for their companies, their sectors and entrepreneurial businesses generally; their companies' financial performance; the types of activity they have undertaken in the past 12 months and intend to take in the year ahead; and their attitudes towards the challenges and opportunities faced by entrepreneurial businesses in the UK in the current economic climate.

The survey for the Index comprised online interviews in April and May with chief executives or managing directors of 163 companies throughout the UK. These companies had up to 500 staff with revenue of between £10 million and £100 million a year. Small and medium-sized companies, with up to 250 employees, comprise the majority of the 4.5 million+ businesses in the UK and account for nearly 60 per cent of UK private sector employment and over 50 per cent of turnover.

Bowmark Capital is a leading private equity firm specialising in smaller UK companies. Founded in 1997, Bowmark manages and advises funds totalling around £700 million on behalf of a blue chip investor base including public pension funds, insurance companies and banks from the UK, US and Continental Europe.

The Bowmark team has extensive experience of investing in growth companies, and has supported over 50 different businesses across a range of industries including business services, leisure, healthcare, media and IT services.

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