

Small & Mid-cap Sentiment Index

August 2018



Key findings:

1. Small & mid-sized quoted companies remain reserved about the UK economic outlook, but...
2. ...they are optimistic about their own prospects and predict job growth within their own businesses.
3. Around a quarter of these companies report that attracting and retaining EU nationals for roles has become harder since the EU referendum, and...
4. ...a small but significant minority of companies say that skills shortages as a result of Brexit are curtailing their growth.

111 small/mid-size UK quoted companies and 42 advisory companies completed this survey in June/July 2018.

This survey has been running since 2011 and the results are presented here in comparison to previous waves. All quotes are taken from open-ended responses.

Executive Summary

Uncertainty around the Article 50 process and Brexit inevitably overshadows the most recent QCA & YouGov survey of small and mid-sized quoted companies.

But whilst optimism about the UK economy remains muted, many are bullish on the prospects and capacity small & mid-caps to being able to ride out – or even take advantage of – disruption that may arise from Brexit.

1. Economic & company outlook

- The small & mid-size quoted company outlook on the UK economy remains muted.
- Optimism on companies' own business prospects remains high and has stayed steady for the past four years (advisors in the sector are much more pessimistic though).
- Some companies are indifferent to Brexit risks because they are either wholly domestic focused or mostly dealing with non-EU international customers and suppliers. In addition, some see the uncertainty as an opportunity where they view the larger, most established companies as being the most vulnerable to potential disruption, with smaller companies able to take advantage.
- Job growth expectations remain high for these companies. 77% expect to increase the number of full-time employees in the next 12 months and average job growth is 8.5% - the highest recorded since this survey began in 2011.

2. Access to capital

- 39% say they plan to raise capital in the next 12 months.
- Raising capital through public equity is the preferred option for

small & mid-sized companies. 62% of respondents say this – the highest this figure has been in the 7 year history of this survey.

- Bank finance is the second most preferred option at 31%.

3. Brexit

- Concerns raised by QCA members about Brexit's impact on hiring and retaining EU nationals led us to seeking data on this. The results are mixed - which likely reflects the varying impact so far on different industries. Some companies report EU workers feeling less welcome in the UK since the referendum, or that employees are seeking to work in other countries due to the decline in the value of the pound.
- A quarter of companies report that attracting or retaining EU nationals for roles has got harder. Nobody said it's got easier.
- Whilst it's a minority, 13% of companies report that their growth is being curtailed as a direct result of skills shortages relating to Brexit.

4. Corporate Governance

- Corporate governance is a hot topic in the world of small caps at the moment - changes in the AIM rules mean AIM companies have to follow a corporate governance code for the first time and, in 2018, updated versions of the *QCA Corporate Governance Code* and *FRC's UK Corporate Governance Code* have been released.
- Companies on the main market of the London Stock Exchange have no choice but to apply the UK Corporate Governance Code, but companies on AIM are free to choose which recognized code they want to adopt. This survey shows that 62% apply the QCA Code and 20% the UK Code, with 14% still deciding which code to apply.

1. ECONOMIC & COMPANY OUTLOOK

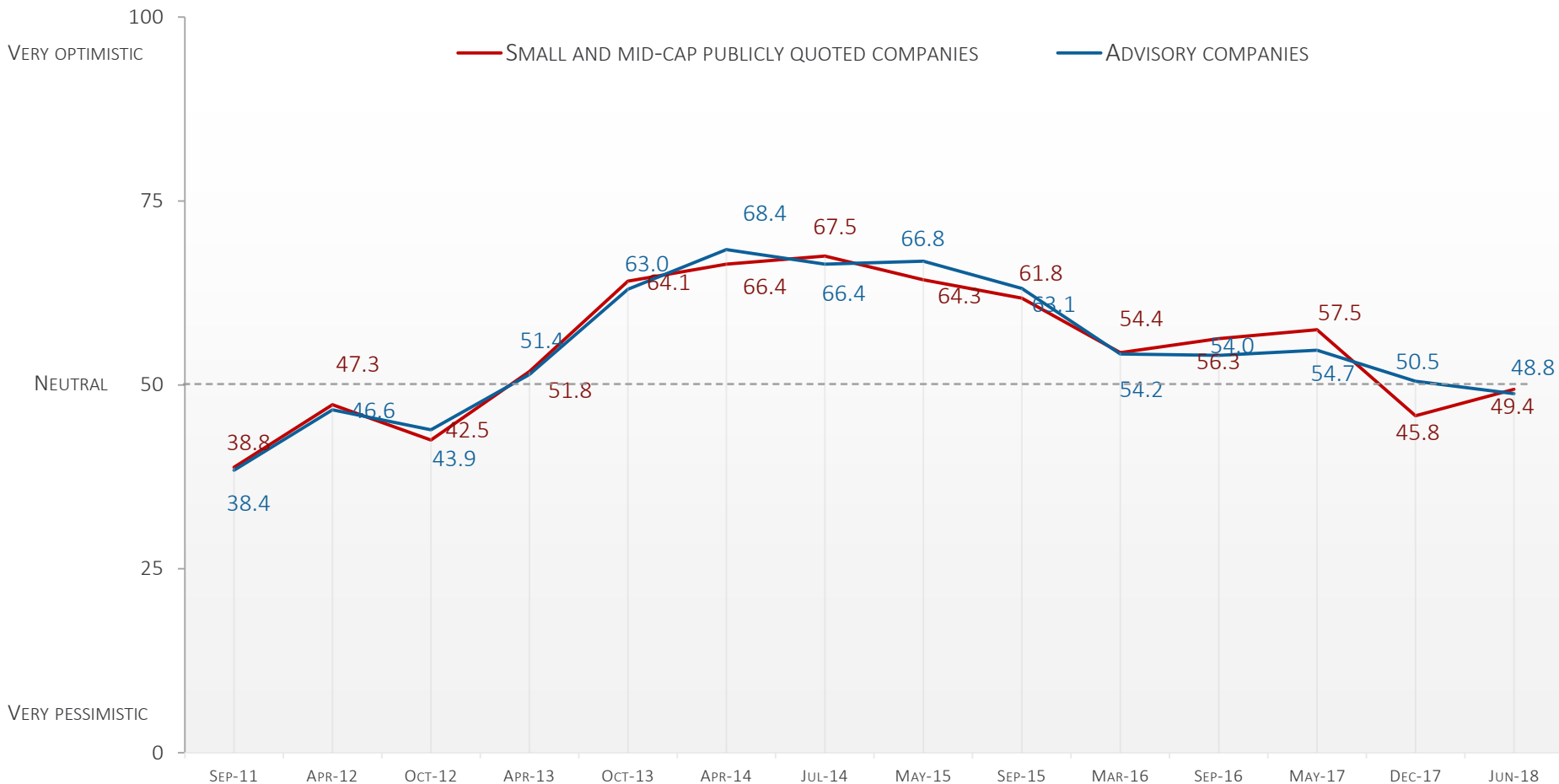
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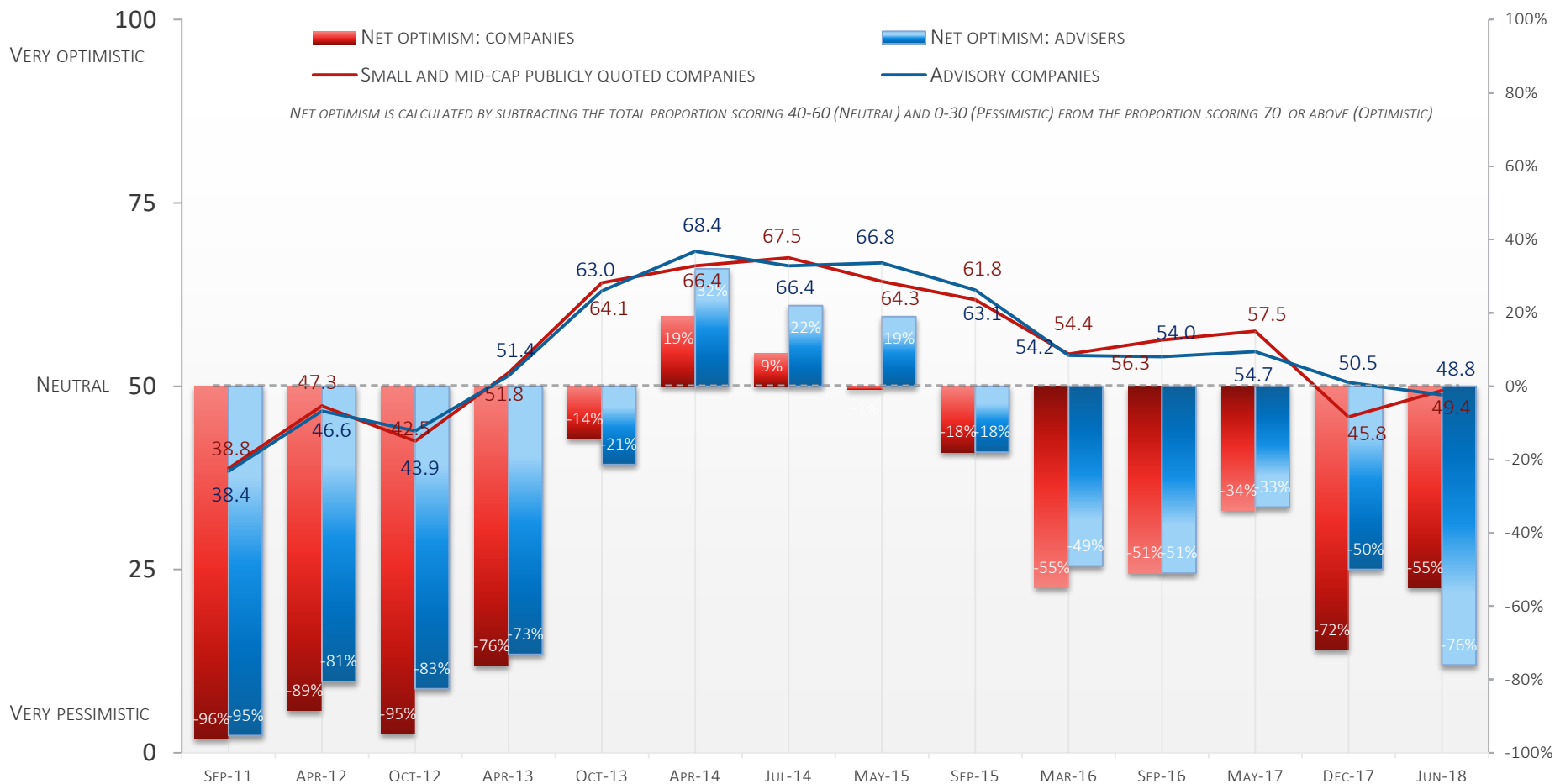
How optimistic or pessimistic do you feel about the UK economy over the coming 12 months?

Mean scores (where 0 represents 'very pessimistic', 50 'neutral' and 100 'very optimistic')



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Companies' views on the UK business outlook (1)

"Negative: 1) Access to capital 2) Regulatory issues regarding investment companies. Positives: 1) The large pool of early stage technology companies in the UK. 2) The large pool of knowledge workers in the UK."

"[We are] positive on the international business environment."

"Brexit is an overhang that we simply need to get through to rebuild confidence. Global trade wars need to calm down. How much longer can growth continue?"

"Positive: Products gaining market share internationally & in UK. Negative: UK growth and government finances."

"Positives: growing sector, international growth, currency devaluing good for exports. Negatives: low pound value effects cost of goods, UK slowdown as Brexit boredom grows, ineffective government."

"Our operations and markets are outside the UK so Brexit has limited impact on our total operations but very material to our UK opportunities. We are in a new and rapid developing market so overall we are very positive."

"We export around 75% (and the global economy is doing just fine) and although the UK is currently heading towards economic disaster through a dysfunctional political process, our products will still be required."

"We don't operate in the UK market so are partly insulated from Brexit which I think will really damage the UK economy. I am optimistic for our growth prospects due to the work we have put into growing our business overseas."

Companies' views on the UK business outlook (2)

"Investments made a few years ago are growing rapidly and are close to fruition. Only negatives are the increasing burden of regulation, particularly the unintended consequences (e.g. Mifid II) and the curious application of regulation (e.g. AIM rules)."

"[We are positive because] most of our business comes from clients in the US and elsewhere in the world than the UK."

"[We have] momentum and continued buoyant demand, but Brexit is a major unknown and potential risk factor."

"We are export led so the downturn in UK economy affects us less."

"[We have an] adaptable business model and are growing internationally."

"[A positive is the] USD FX rate. The pound is likely to devalue further, benefiting our share price."

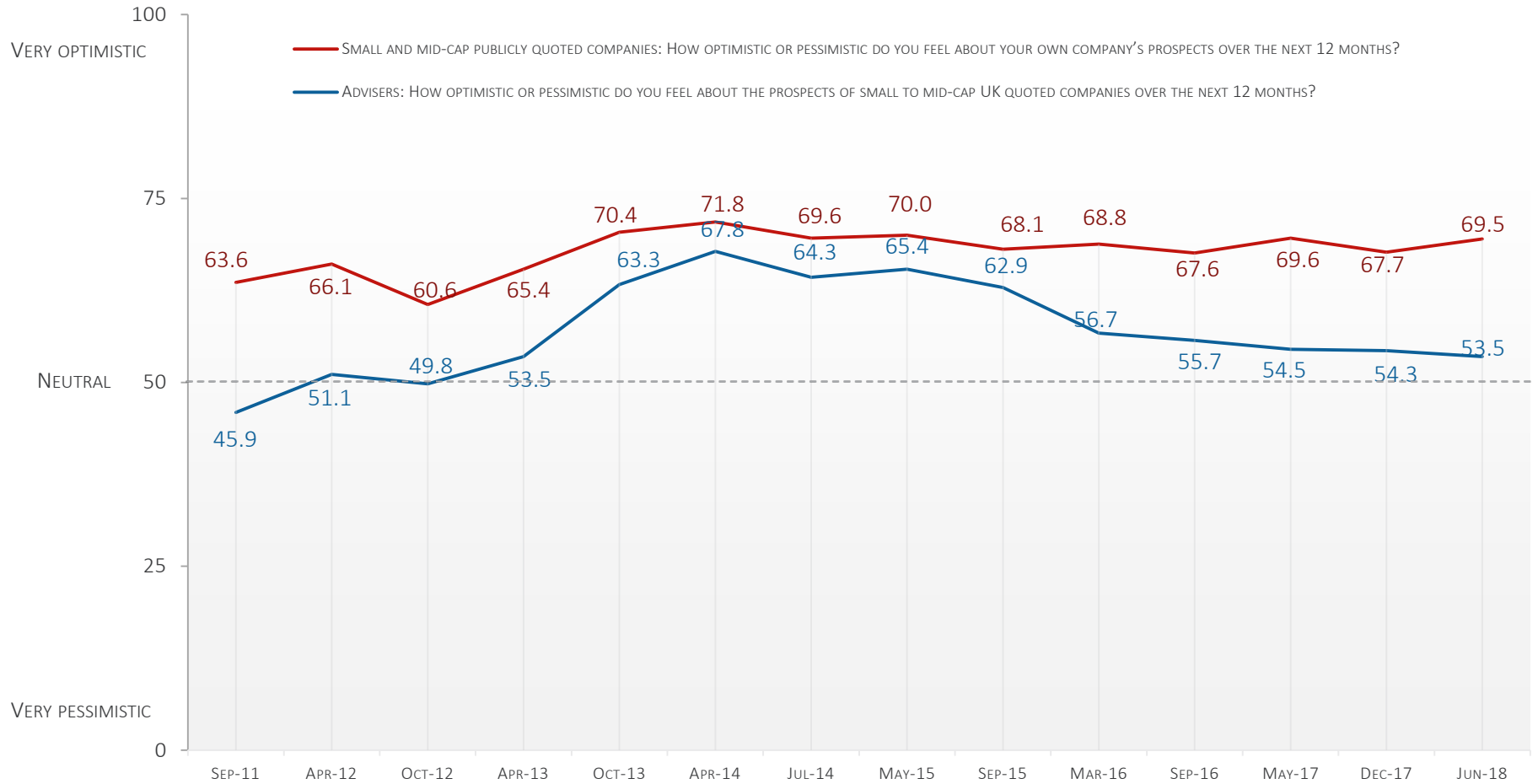
"Positive opportunities in overseas markets. Negative factors include ability to recruit and retain good people."

"We are only UK based and therefore not exposed to exporting concerns, but we are concerned about the availability of labour which is becoming increasingly tight."

"[We are optimistic because of] Innovation and a positive market reaction to products. Not particularly fearful of Brexit (but of course, this remains an uncertainty)."

Optimism/Pessimism toward business prospects.

Mean scores (where 0 represents 'very pessimistic', 50 'neutral' and 100 'very optimistic')

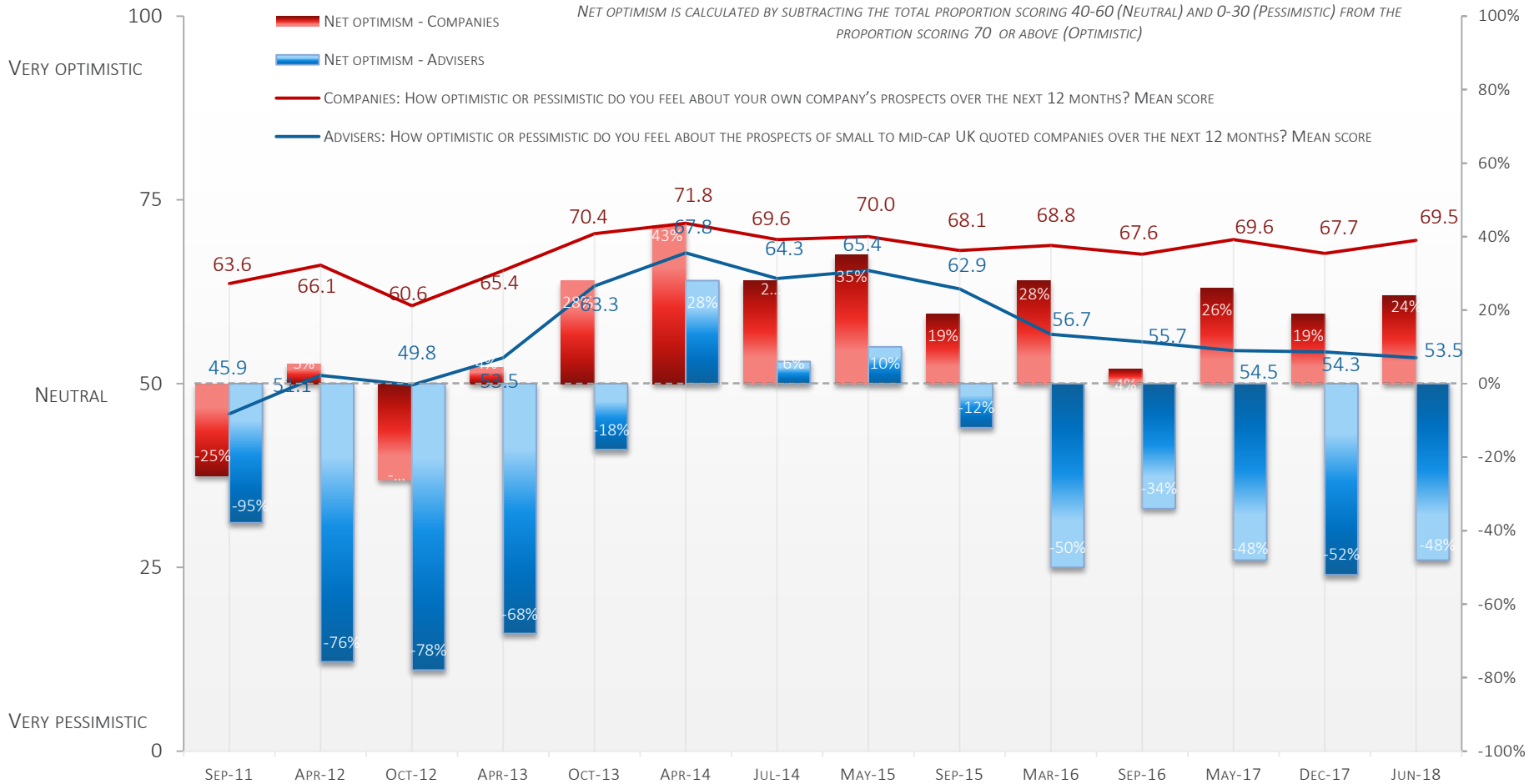


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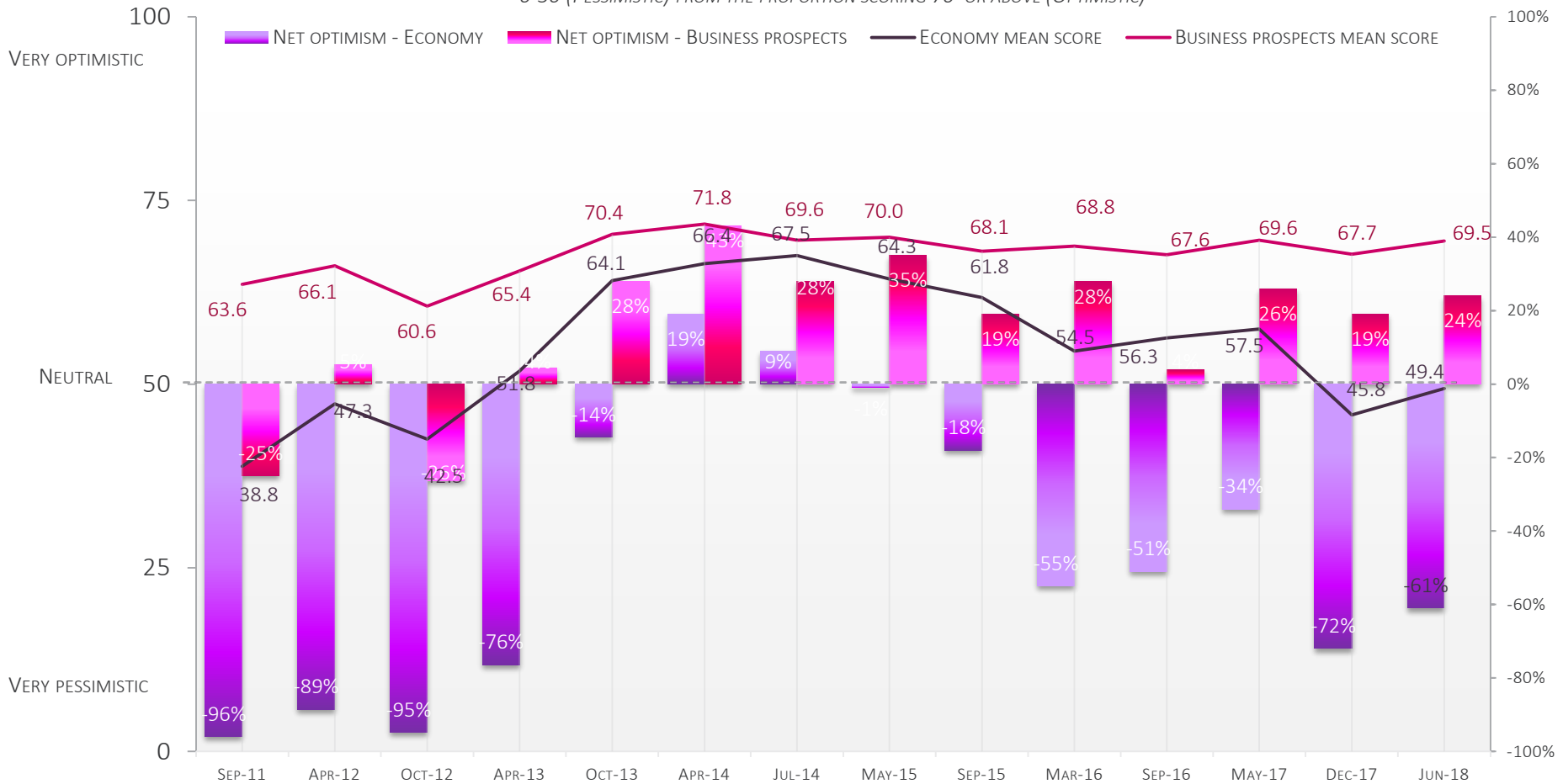


Optimism/Pessimism: UK economy vs. Business prospects.

Mean scores (where 0 represents 'very pessimistic', 50 'neutral' and 100 'very optimistic')

Small and mid-cap quoted companies only

NET OPTIMISM IS CALCULATED BY SUBTRACTING THE TOTAL PROPORTION SCORING 40-60 (NEUTRAL) AND 0-30 (PESSIMISTIC) FROM THE PROPORTION SCORING 70 OR ABOVE (OPTIMISTIC)



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Investors & advisors views on small/mid cap outlook

"I think there will be positives and negatives which will even out. However I think SMEs may have more opportunity to be flexible and change to suit the unpredictable circumstances compared to larger business which could be susceptible to bigger problems."

"There are a great deal of young enterprising entrepreneurial companies in the UK who have low central overheads and can make quick decisions. This compares with the large corporates who are totally the opposite."

"[We face] uncertainty about work from major companies who are hesitant about investment plans because of Brexit."

"[We are concerned about the] lack of progress in Brexit discussions, the political instability in the UK and the ability for the UK government to enact changes which secure and protect the interests of small and mid-cap entities."

"[We are optimistic because of] low interest rates, low unemployment and BREXIT - which will unleash new opportunities"

"Positives are continued low interest rates and good investment opportunities. Negative is the Brexit uncertainty."

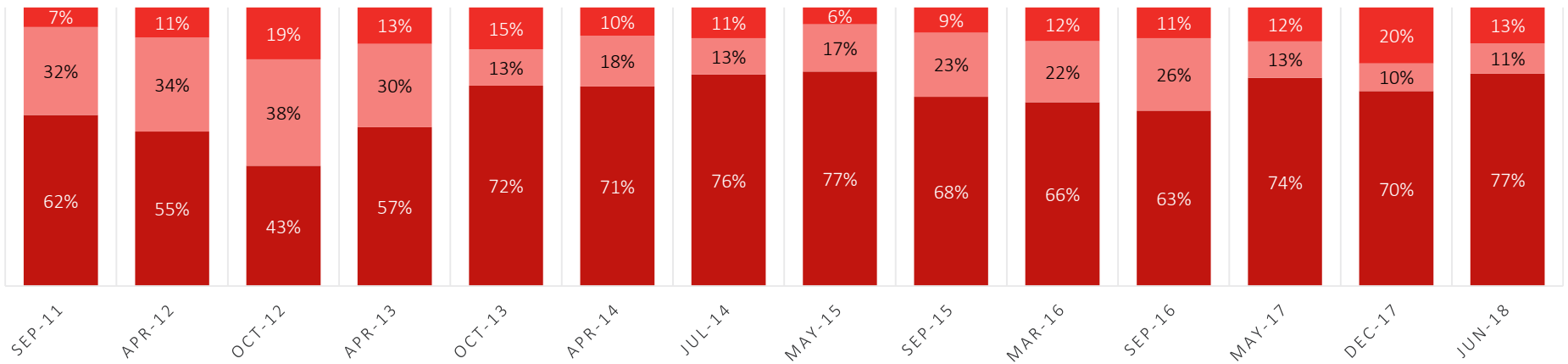
"The small/mid cap market remains active but [we have] concerns about the economy and final shape of Brexit, plus potential impact of recent failures e.g. Quindell, Conviviality to name two, could be damaging."

Expectations regarding job growth

SMALL AND MID-CAP PUBLICLY QUOTED COMPANIES

DO YOU EXPECT THE NUMBER OF FULL TIME EMPLOYEES IN YOUR BUSINESS TO INCREASE OR DECREASE OVER THE NEXT 12 MONTHS?

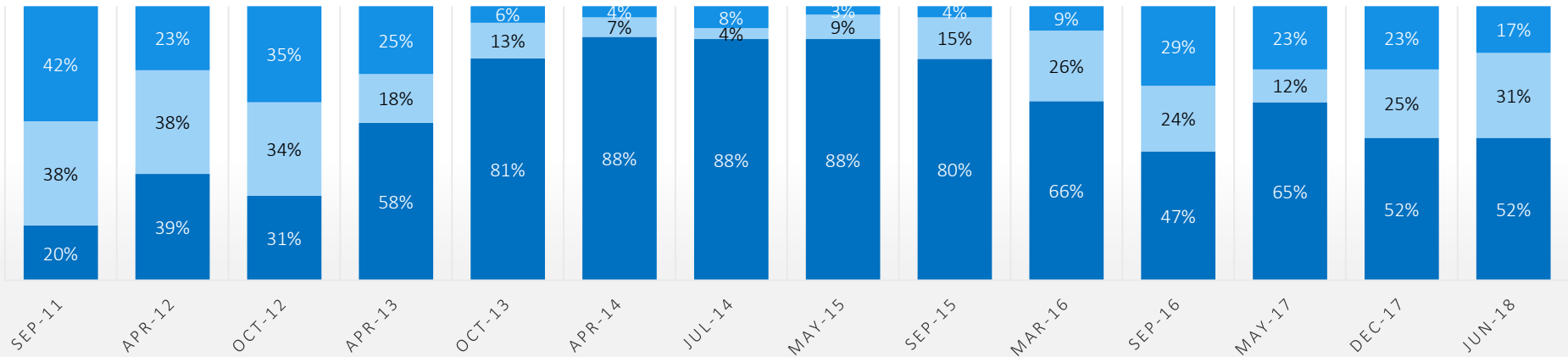
■ INCREASE ■ NO CHANGE ■ DECREASE



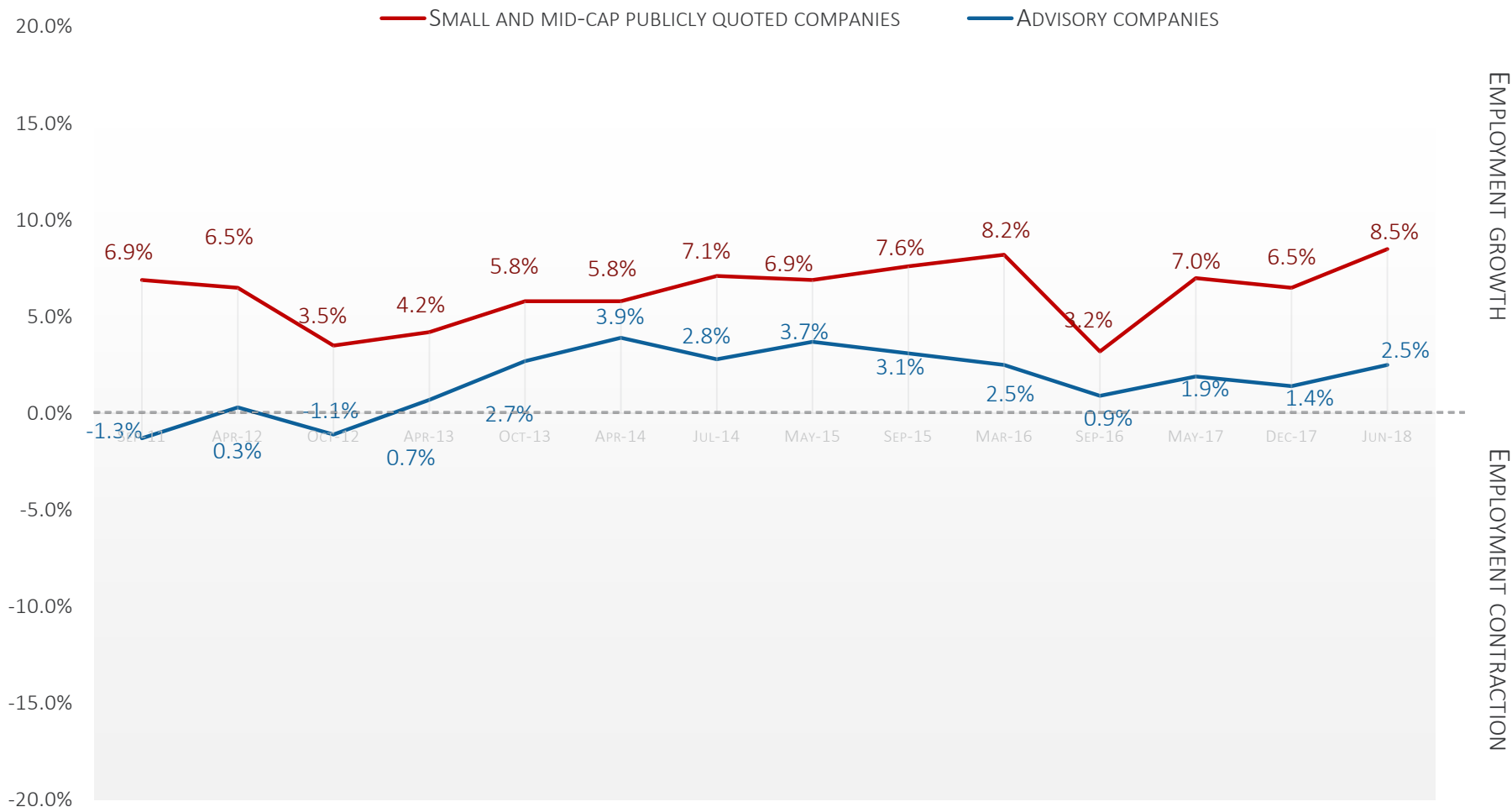
ADVISORY COMPANIES

DO YOU EXPECT THE NUMBER OF FULL TIME EMPLOYEES IN SMALL TO MID-CAP UK QUOTED COMPANIES TO INCREASE OR DECREASE OVER THE NEXT 12 MONTHS?

■ INCREASE ■ NO CHANGE ■ DECREASE



Expectations regarding job growth: Mean expected employment change over the next 12 months

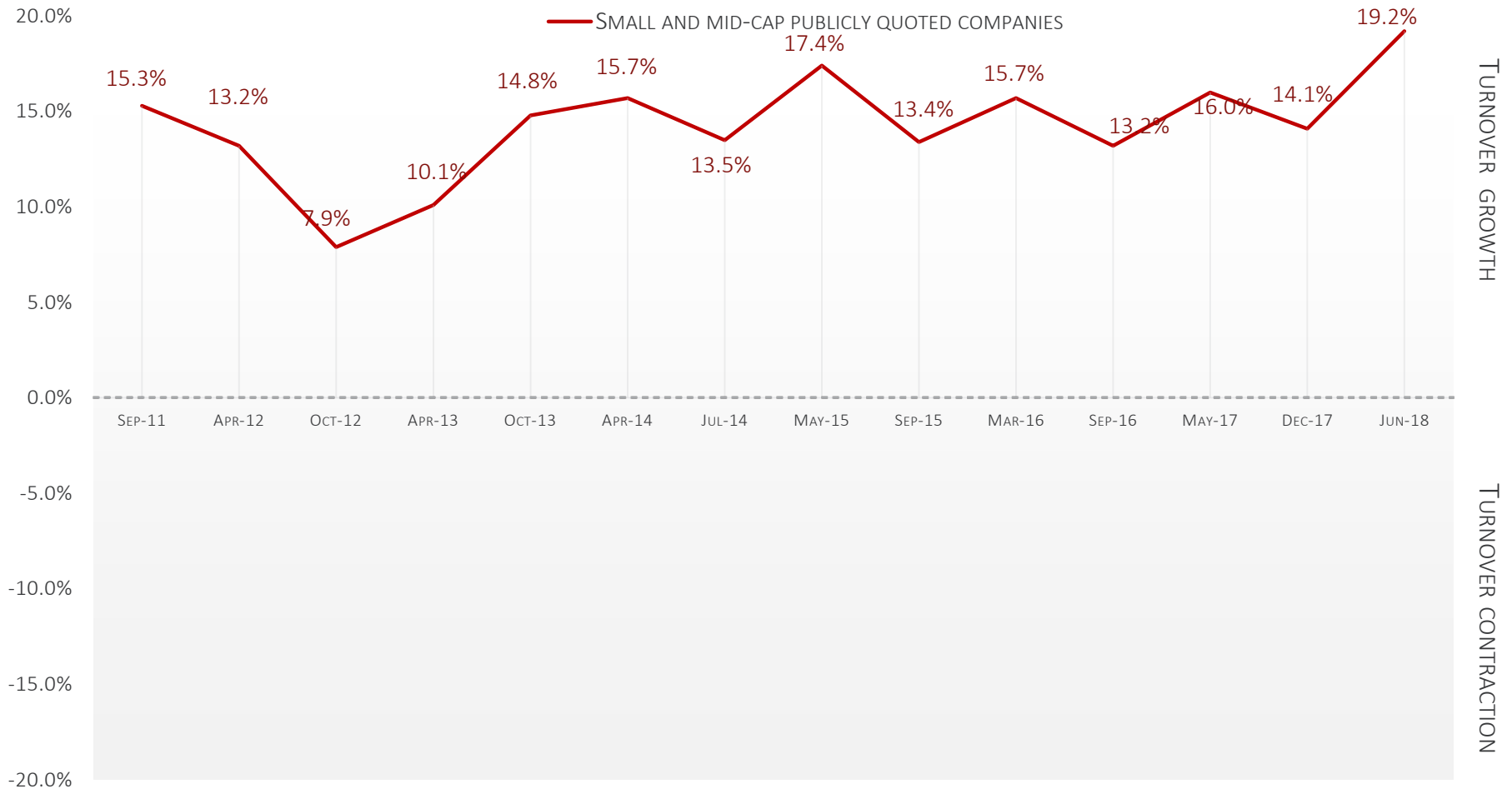


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Expectations regarding turnover: Mean expected turnover change over the next 12 months

Small and mid-cap companies only (not asked to advisers)



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2. ACCESS TO CAPITAL

2. Access to capital

39% of small/mid-size quoted companies are looking to raise capital in the next 12 months. This is an increase from 28% in December 2017, but the same as when asked in May 2017.

The majority prefer to raise finance via public equity – this should reflect that the companies being surveyed are publicly listed - but with 62% of respondents preferring this avenue, it is the highest this figure has been in the seven year history of this survey (going back to 2011).

On why companies wish to finance through public equity:

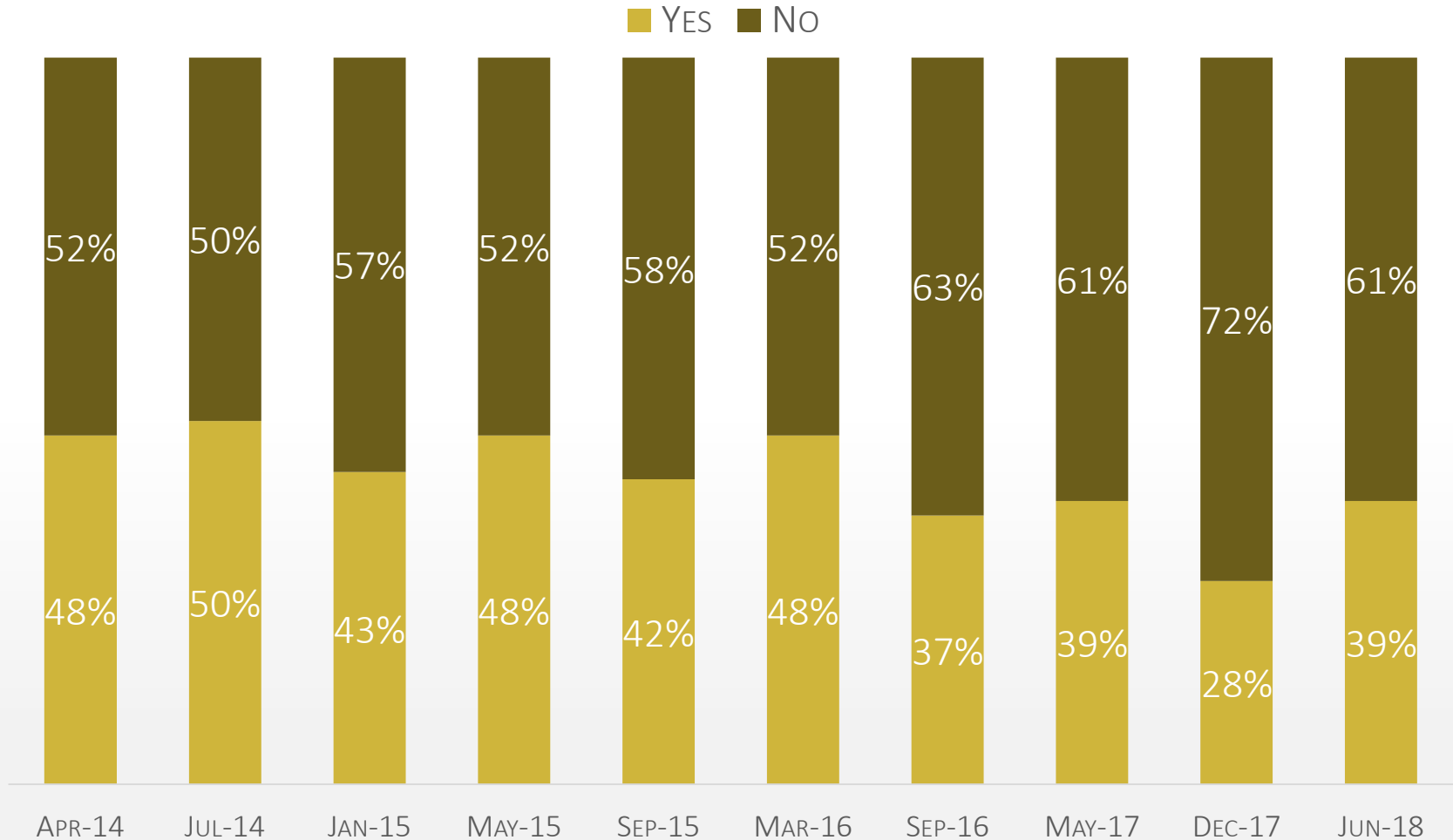
- *“[It’s] efficient as public markets understand our sector growth opportunity.”*
- *“We are credible, so the investor community will support us.”*
- *“With supportive shareholders, it’s the cheapest way of providing long term investment funds.”*
- *“It’s easier to access the public equity markets than to raise venture capital or private equity. Debt is expensive and relies on collateral of which we have none to speak of.”*
- *“Because it provides some flexibility should matters take longer or cost more. Lending is covenant driven so a bank takes control should things fall even slightly short. Private equity the same.”*
- *“Because we are listed and we want our shareholders to participate in the upside.”*
- *“It has always been the most direct and quick way to raise enough capital, other means are relatively cumbersome and expensive for the amount raised by comparison.”*

Bank finance is the second preferred option at 31%. Those companies preferring this say:

- *“[It] avoids dilution [and is the] cheapest for some.”*
- *“It’s easy for us to do and, as a successful PLC that continually pays down its debt, there is no shortage of lenders.”*
- *“[We have a] good relationship with our bank and our share price is too low to issue equity.”*

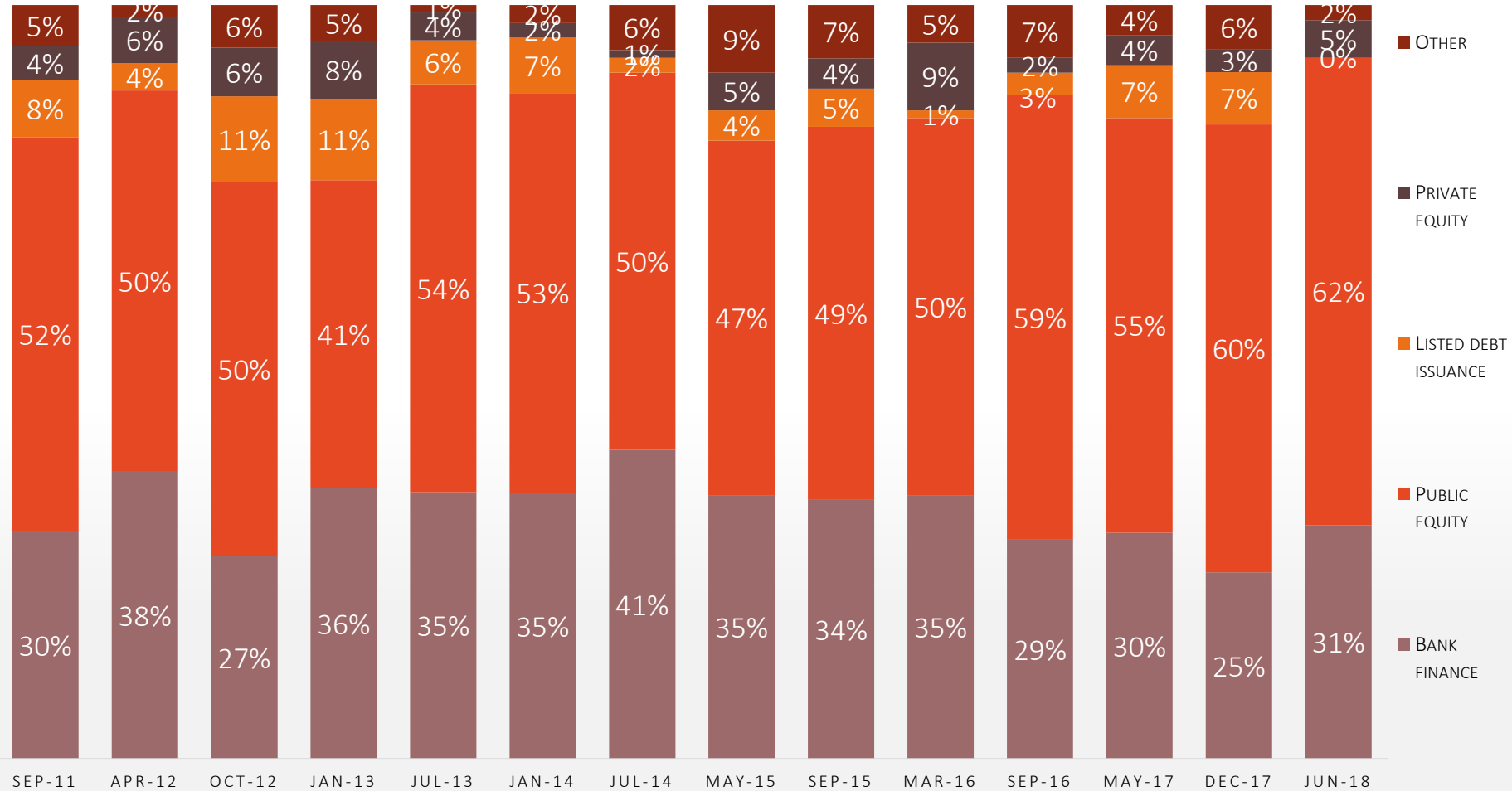
Raising capital for small and mid-caps

ARE YOU CONSIDERING RAISING CAPITAL FOR YOUR COMPANY IN THE NEXT 12 MONTHS?



Raising Capital (small and mid-caps only)

WHAT WOULD BE YOUR PREFERRED WAY OF RAISING CAPITAL, IF THE NEED AROSE IN THE NEXT 12 MONTHS?

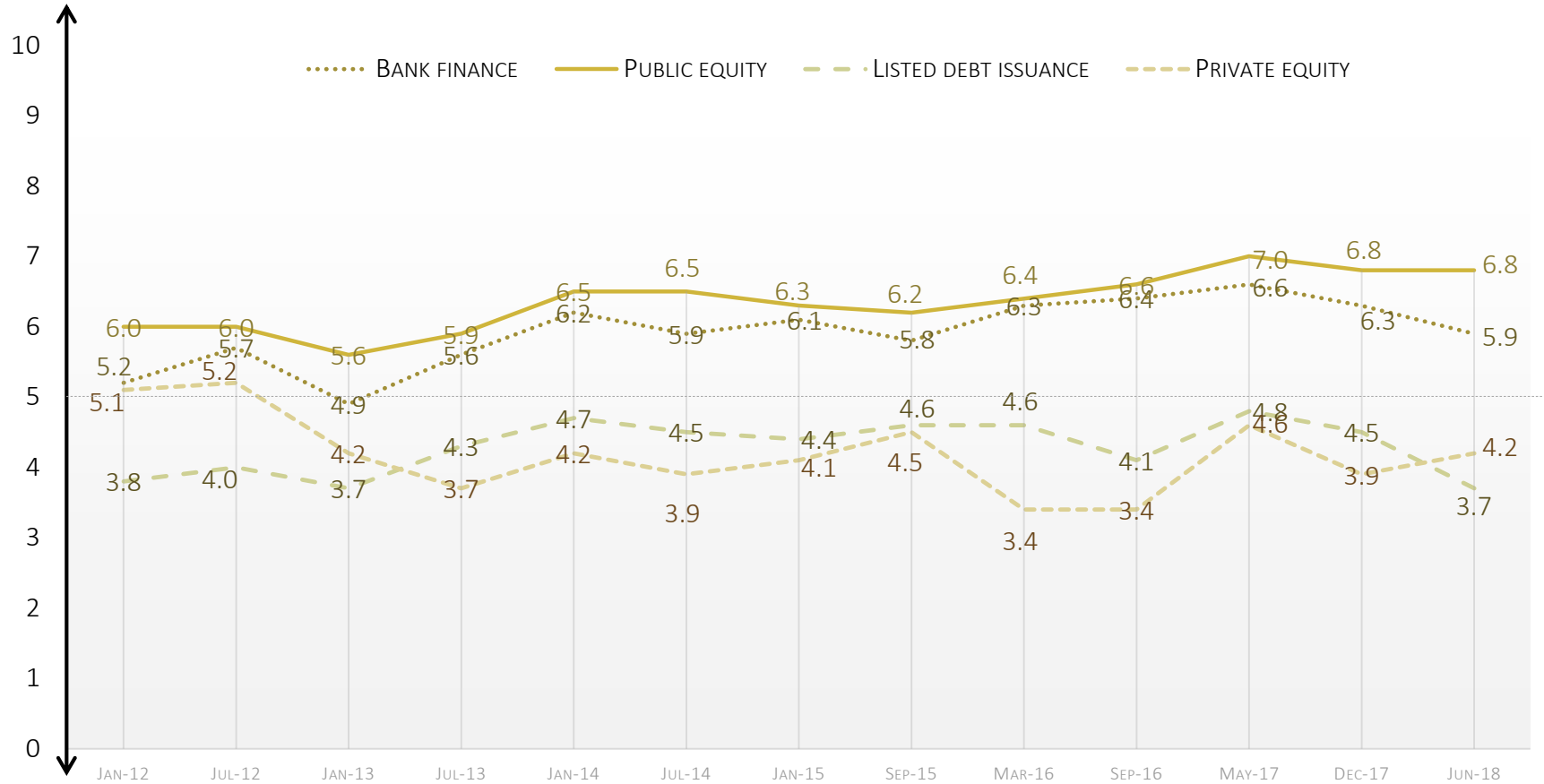


Ease of raising capital for small and mid-caps

HOW EASY OR DIFFICULT WOULD YOUR COMPANY CURRENTLY FIND IT TO RAISE FINANCE THROUGH THE FOLLOWING CHANNELS?

MEAN SCORES - COMPANIES

EXTREMELY EASY

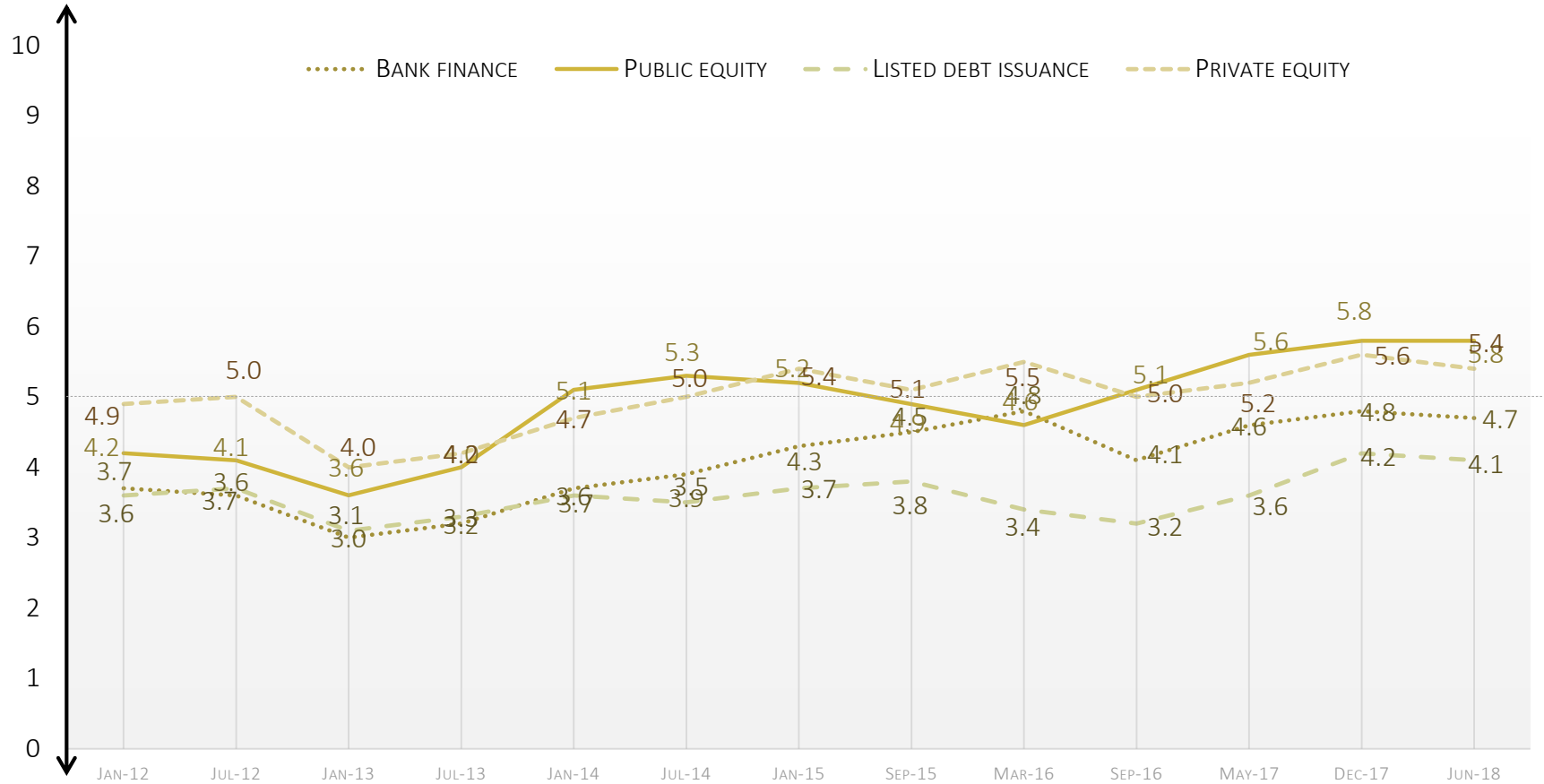


IMPOSSIBLE

Ease of raising capital for small and mid-caps

HOW EASY OR DIFFICULT DO YOU BELIEVE SMALL TO MID-CAP UK QUOTED COMPANIES ARE CURRENTLY FINDING IT TO RAISE FINANCE THROUGH THE FOLLOWING CHANNELS? MEAN SCORES - ADVISERS

EXTREMELY EASY



IMPOSSIBLE

Ease of raising capital for small and mid-caps

HOW EASY OR DIFFICULT WOULD YOUR COMPANY CURRENTLY FIND IT TO RAISE FINANCE THROUGH THE FOLLOWING CHANNELS?

JUNE 2018 (SCALE: 0 IMPOSSIBLE - 10 EXTREMELY EASY)

		HARD (0-3)	NEUTRAL (4-6)	EASY (7-10)	DON'T KNOW	MEAN
BANK FINANCE	SMALL/MID CAPS	21%	23%	48%	8%	5.9
	ADVISERS	26%	45%	21%	7%	4.7
PUBLIC EQUITY	SMALL/MID CAPS	5%	31%	59%	5%	6.8
	ADVISERS	7%	50%	40%	2%	5.8
LISTED DEBT ISSUANCE	SMALL/MID CAPS	32%	14%	14%	40%	3.7
	ADVISERS	21%	36%	10%	33%	4.1
PRIVATE EQUITY	SMALL/MID CAPS	31%	23%	17%	30%	4.2
	ADVISERS	5%	74%	19%	2%	5.4

3. BREXIT AND STAFFING

3. Brexit & Staffing

Concerns expressed by QCA members about Brexit's impact on hiring and retaining EU nationals led to us seeking data on this.

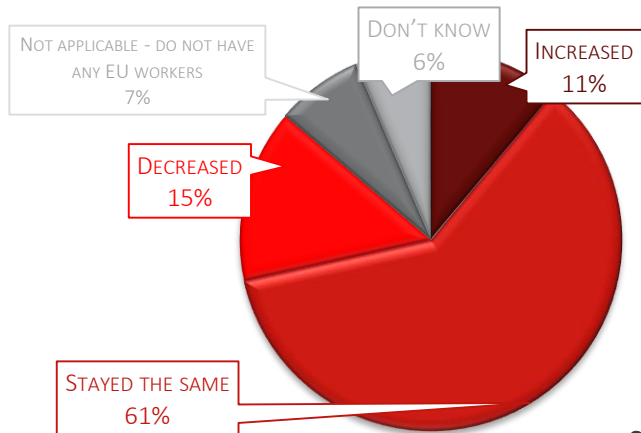
The results are mixed - which likely reflects the varying impact so far on different industries.

- A quarter of companies report that attracting (25%) or retaining (23%) EU nationals for roles has got harder. Nobody said it's got easier.
- 13% of companies report that their growth is being curtailed as a direct result of skills shortages relating to Brexit.
- Those companies that report difficulties in recruiting and retaining (non-UK) EU nationals, note that EU workers are feeling less welcome in the UK since the referendum, that administrative challenges are deterring them, or that they are seeking to work in other countries due to the decline in the value of the pound.

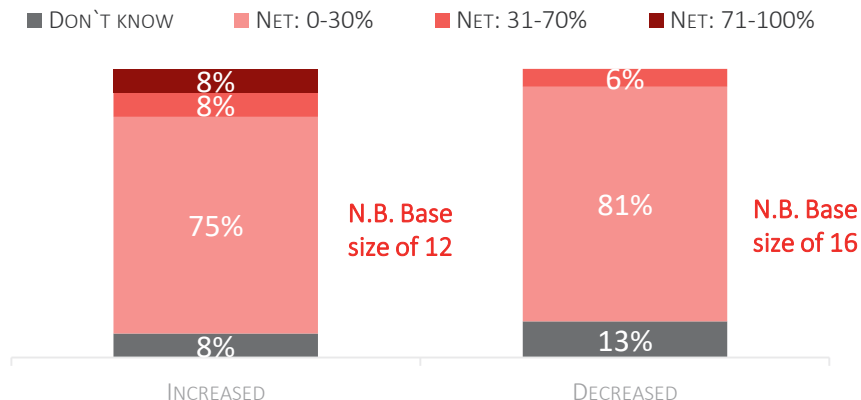
Percentage change of EU workforce

SMALL AND MID-CAP PUBLICLY QUOTED COMPANIES

SINCE THE UK'S EU REFERENDUM IN JUNE 2016, HAS THE PERCENTAGE OF EU NATIONALS IN YOUR OVERALL WORKFORCE...

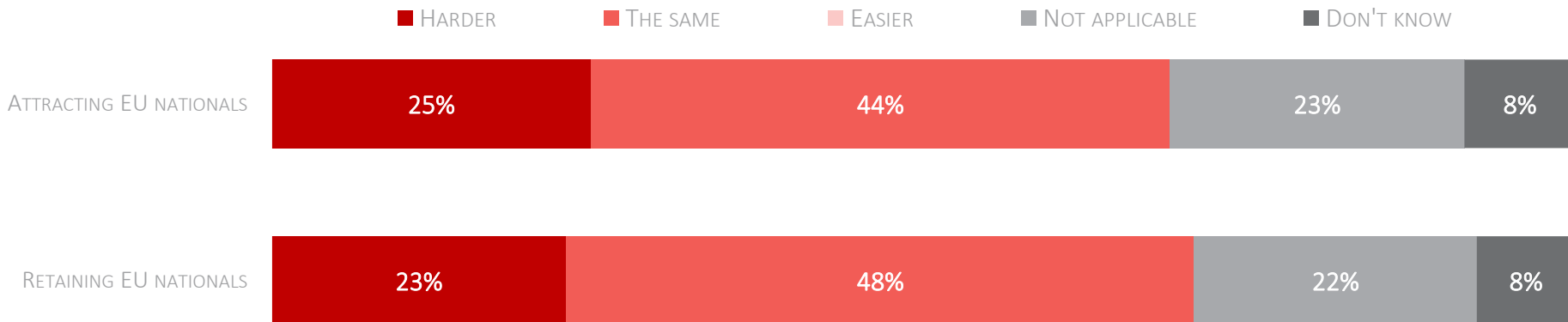


AS A PERCENTAGE, PLEASE EXPRESS ROUGHLY BY HOW MUCH THE TOTAL PERCENTAGE OF EU NATIONALS IN YOUR COMPANY'S WORKFORCE HAS...?



SMALL AND MID-CAP PUBLICLY QUOTED COMPANIES

SINCE THE REFERENDUM, HAVE YOU FOUND...



Company views on Brexit and staffing

Those companies that report difficulties in the recruitment and retention of workers from (non-UK) EU countries generally note 3 reasons for this:

1) European workers perceive a less welcoming atmosphere in the UK since the referendum:

- *"[EU nationals] see less of a future in the UK."*
- *"EU nationals feel the UK is a hostile climate for them so are less inclined to stay or relocate in the case of a new offer. Also, EU countries view Brexit in a very poor light and this has tarnished our reputation both as an employer and as a supplier."*
- *"Software developers can pick and choose where they want to work and are in demand across Europe. The UK is no longer as attractive a destination as it was. What keeps the UK tech sector afloat is its ability to attract equity investment. However awareness of equity investment as a method of fundraising is becoming much more sophisticated elsewhere in Europe. So the UK's USP is fast receding."*
- *"Fewer EU nationals want to work in the UK due to Brexit."*
- *"The perception of UK since Brexit is not a good one."*
- *"EU citizens are reluctant to come and work in the UK."*
- *"We have had people leave to go back to the EU because of hostility they sensed living and working in the UK."*
- *"When offered other opportunities the uncertainty of Brexit becomes a factor in deciding whether to stay or go. This was never previously an issue and we had a good record of retaining staff."*

Company views on Brexit and staffing

2) Employees are seeking to work in other countries due to the decline in the value of the pound:

- *“The weakness of the £ has meant that a number of our workers have moved to other markets and a number have returned home. We are not seeing that many applicants from new EU nationals.”*
- *“Exchange rate is less attractive for sending funds to their home lands.”*
- *“Given the uncertainty caused by Brexit and issues around citizenship a number of our workers have moved on. A number of our workers were in the habit of saving money for a return to their place of birth or sending money back to families. Weaker sterling means both are less attractive. Additionally some home markets have picked up dramatically (e.g. Poland) and they have been working hard to attract their citizens back home.”*
- *“With home economies doing better, and the collapse of the GBP, EU nationals see less incentive to stay in the UK only to pay higher living costs and face a more hostile environment.”*

3) EU workers face administrative issues and uncertainty about future rights:

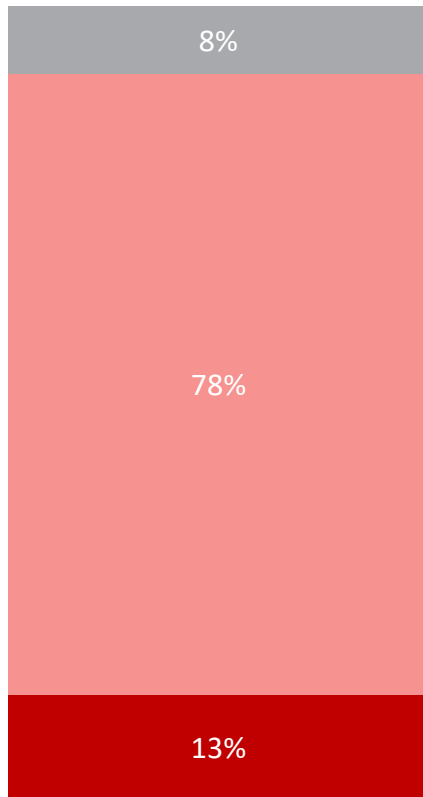
- *“It is hard to get a working visa.”*
- *“Uncertainty over status post-Brexit.”*
- *“Nervousness about their future ability to stay and work in the UK.”*
- *“Because they don’t know whether the Government will honour its moral obligations to them. Nor do the rest of us!”*
- *“Uncertainty over right to live and work in the U.K. post-Brexit.”*
- *“Uncertainty of some EU nationals has meant they have made decisions to leave the UK and return home.”*
- *“The uncertainty caused by Brexit has caused the most talented to look elsewhere for work.”*

Growth being curtailed?

SMALL AND MID-CAP PUBLICLY QUOTED COMPANIES

IS THE GROWTH OF YOUR COMPANY BEING CURTAILED AS A RESULT OF A SHORTAGE OF SKILLS SINCE THE REFERENDUM TO LEAVE THE EU?

■ YES ■ NO ■ DON'T KNOW

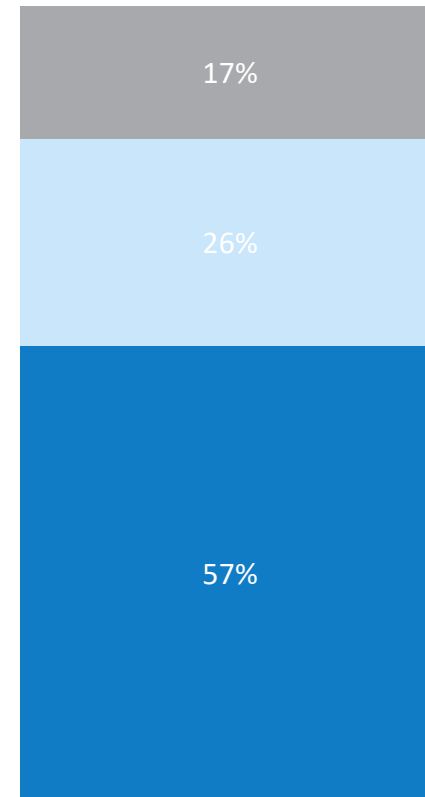


COMPANIES

ADVISORY COMPANIES

DO YOU THINK THAT THE GROWTH OF SMALL AND MID-CAP UK QUOTES COMPANIES IS BEING CURTAILED AS A RESULT OF A SHORTAGE OF SKILLS?

■ YES ■ NO ■ DON'T KNOW



ADVISORS

What the Government can do

Those companies facing difficulties recruiting or retaining EU nationals were asked what actions they believe the Government can take to help with this. Recommendations were largely in three areas:

1. Clarify the new UK immigration system

- *“We will set up an EU-based R&D centre if we can't bring EU citizens into our UK centre. Clearly the UK government could assist by delivering a clear agreed understanding of how trading and immigration will work between the EU and Britain post-Brexit as soon as possible; it's already significantly overdue.”*
- *“The current government's anti-business and anti-immigrant tone is very unhelpful and causing high levels of uncertainty that is resulting in new investments being made outside the UK.”*

2. Ensure skilled labour from the EU can still be recruited easily after Brexit

- *“Keep the borders open for a number of different skill groups”*
- *“Skilled workers should be left out of migration quotas. UK education needs radical overhaul to be more flexible around non-academic skills”*
- *“The Government should make sure that we can still employ sufficient individuals from anywhere overseas with the skills we cannot find in sufficient supply the UK, at least until the UK employment market and/or the education system have evolved to provide sufficient people with the skills we need.”*

3. Make it easier to hire from outside the EU

- *“We can recruit from US or Eastern Europe. Make this easier.”*
- *“Making sure we have access to non-EU graduates with appropriate visas would address any gap.”*
- *“Increase visa caps for non-EU workers (although not Brexit would make this unnecessary).”*

Other

- *“In the short term little the government can do. Education is the key, UK applicants are poorly qualified.”*
- *“Give incentives to smaller companies to recruit more apprentices as opposed to introducing an apprentice levy.”*

On Government listening to business...

“Business, including UK headquartered business, have alternatives to the UK. If the government does not listen to the concerns of business then there are plenty of countries that will welcome tech companies like ours - Netherlands, Ireland, Sweden are all attractive locations for us. Do not take UK business for granted.”

*“Brexit is, and will be destructive for business prospects and jobs. As a country and as a supplier our reputation is diminished I find myself as CEO constantly having to apologise to staff and to customers for the actions and words of our elected government officials. The current government's anti-business and anti immigrant tone is very unhelpful and causing high levels of uncertainty that is resulting in new investments being made outside the UK- JLR, Airbus, BMW are just some examples of our customers who are sending investment and jobs outside the UK. The most important thing the Government should do is not dismiss the concerns of business with statements like "f*ck business".”*

What actions companies are taking

Those companies facing difficulties recruiting or retaining EU nationals were asked what actions they will take in response to this.

These were broadly in three areas:

1. Recruiting more from the UK or from non-EU countries

- *“The skills gap is rife, regardless of EU nationals. We are starting with the schools and reforming prisoners as a way to help solve the ongoing puzzle.”*
- *“We are trying local people but have little positive response.”*
- *“[We will] recruit outside of the EU.”*
- *“[We will] employ UK or non-EU citizens.”*
- *“[We will] Fight harder over the smaller local pool. Any government action will not take effect for years and so will be of little value.”*
- *“We train young people and always have done. The apprentice scheme the government introduced did nothing to help businesses in this regard though.”*

2. Moving jobs outside of the UK

- *“We will set up or leverage operations in countries that have the required resources outside of the UK.”*
- *“[We will] outsource overseas.”*
- *“[We will] recruit staff into our overseas subsidiaries to fill the open roles.”*
- *“The practical answer is to use developers based outside the UK, e.g. Poland, Latvia, Czech Republic, Bulgaria, Ukraine, Israel etc. It does not really matter where the developers are provided they can do the job - which they can.”*
- *“We can move the roles to a EU base or to the US.”*
- *“[We have] contracted some roles out.”*

3. Increasing automation or looking for other efficiencies to reduce need for labour

- *“[We are] looking to automate our processes so we are less reliant on people.”*
- *“We are automating our processes so we require 25% fewer people.”*
- *“We are becoming more efficient through capital investment and labour allocation.”*

4. CORPORATE GOVERNANCE

4. Corporate Governance

Corporate governance is a hot topic in the world of small caps at the moment - changes in the AIM rules mean AIM companies to have to follow a recognised corporate governance code for the first time and, in 2018, updated versions of the QCA Corporate Governance Code and FRC UK Corporate Governance Code have been released.

Companies on the main market of the London Stock Exchange have no choice but to apply the UK Corporate Governance Code, but companies on AIM are free to choose which code they want to adopt.

This survey shows that 62% currently apply the QCA Code and 20% the UK Code, with 14% still deciding which code to apply. A small number of overseas (dual-listed) companies apply their national code (e.g. for Australia or South Africa).

When asked why their company had chosen to apply the QCA Code, typical answers were:

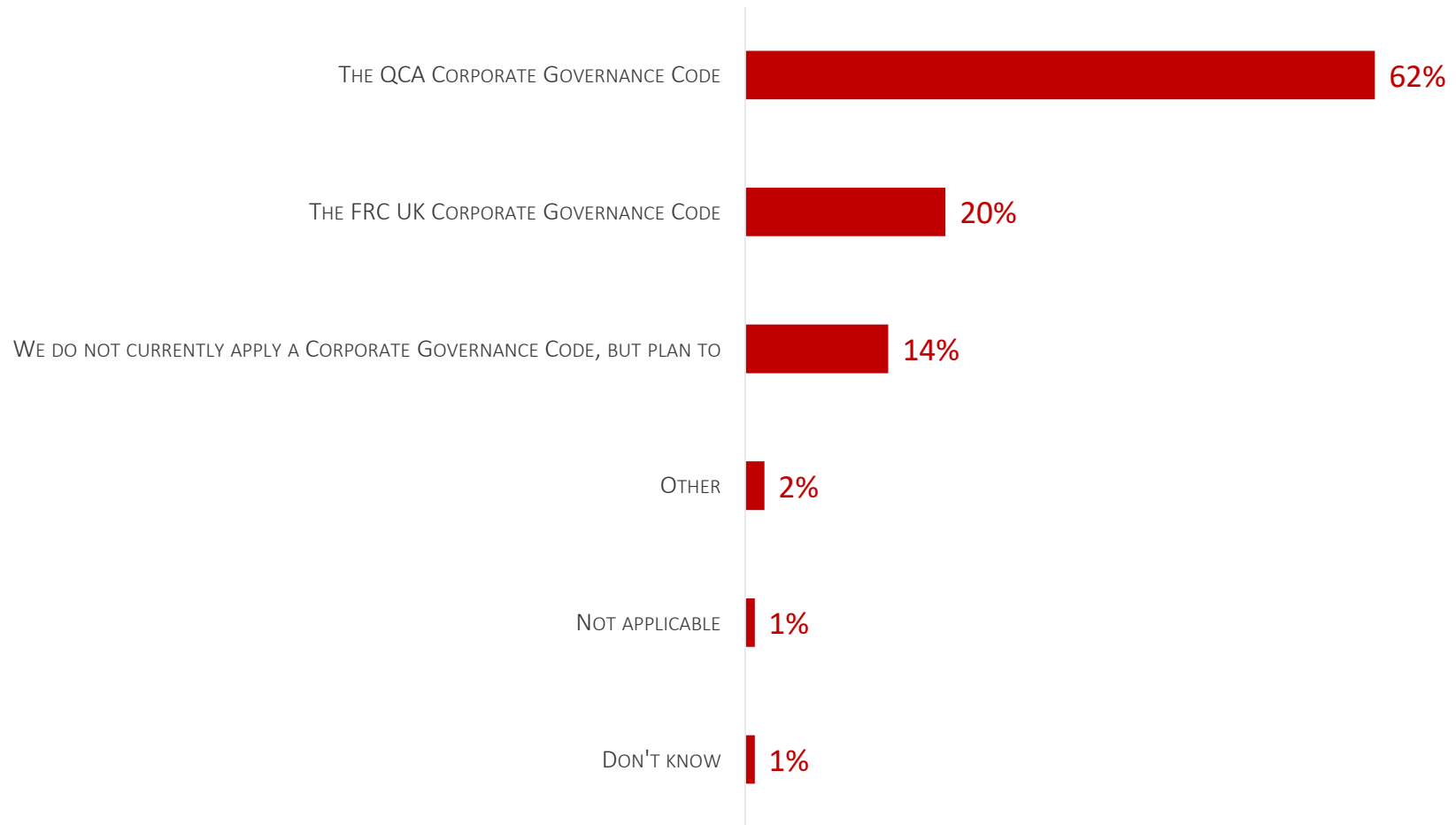
- *"We are a small cap listed company on AIM and this is the most appropriate code for our size and resource."*
- *"It is better suited to our current size and scale than the UK Corporate Governance Code."*
- *"It's popular amongst our investors."*
- *"Because it is well designed, company friendly and is a good corporate governance code."*
- *"[It is] simpler than FRC."*
- *"Recent IPO needed a lot of small company support and the right 'weight' of governance."*
- *"Because it has been designed for companies like mine."*
- *"Most pragmatic and most suitable for smaller AIM-listed companies such as ours."*
- *"Its principled approach is very well suited for the size and complexity of our business."*
- *"[It was] written by people who understand SME quoted companies."*
- *"I feel it is the most appropriate code with clear principles."*

Those companies that adopt the FRC's UK Corporate Governance Code said:

- *"The Code requirements are clearer and we try to align with Fully Listed."*
- *"Stronger governance = stronger shareholder following."*
- *"Because we are fully listed so have no choice."*
- *"[Because of] shareholder expectations."*

Corporate Governance Codes

WHICH OF THE FOLLOWING CORPORATE GOVERNANCE CODES, IF ANY, DOES YOUR COMPANY CURRENTLY APPLY?



Average hours expected to spend on new AIM Rule

Choosing which Corporate Governance Code to apply, and then taking the necessary steps to apply it take time.

Each code has different requirements regarding website or annual report disclosures, for instance.

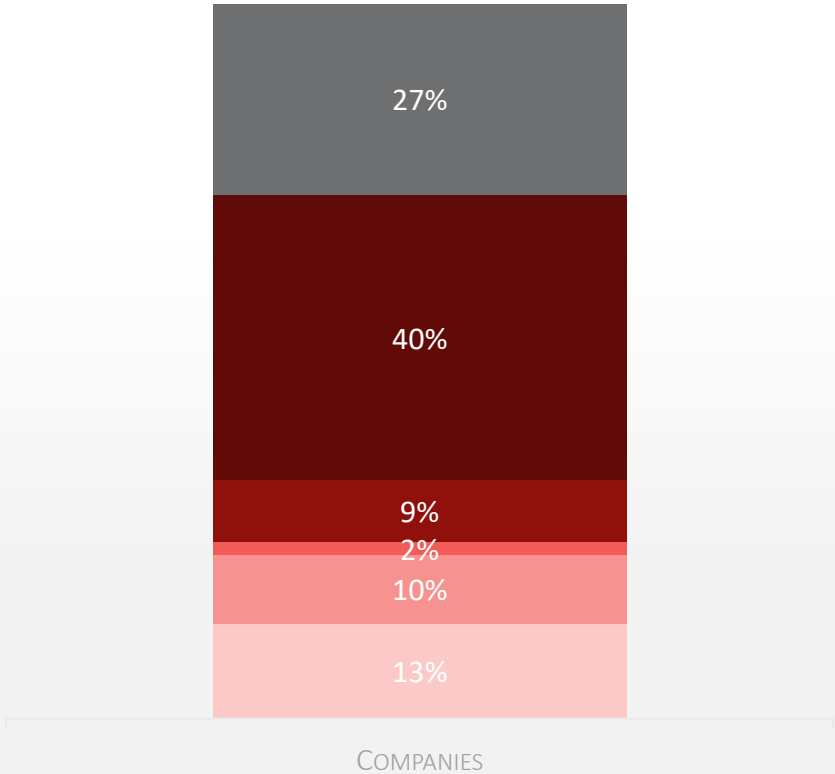
We asked companies for an estimate of the number of hours senior management expect to put into this process.

SMALL AND MID-CAP PUBLICLY QUOTED COMPANIES

ROUGHLY, HOW MANY SENIOR MANAGEMENT HOURS IN TOTAL DO YOU EXPECT TO SPEND ON THE NEW AIM RULE REQUIRING COMPANIES TO ADOPT A CORPORATE GOVERNANCE CODE?

5 OR LESS 6-10 11-15 16-20 MORE THAN 20 DON'T KNOW

Mean: 47.95 hours



Background & methodology

- 153 interviews were conducted between 25/06/18 and 11/07/18.
- 111 from small and mid-cap UK quoted companies, 42 from advisory companies (for example, investors, lawyers, and accountants servicing the small & mid-cap sector).
- Methodology: This survey has been conducted using an online interview administered to members and associates of the QCA. An email was sent to the QCA database, inviting them to take part in the survey and providing a link to it. A link to the survey was also circulated by the QCA to their contacts. The sample definition is "small and mid-cap UK quoted companies and advisory companies". The responding sample is weighted by industry to be representative of small and mid-cap UK quoted companies, as derived from London Stock Exchange data, but the advisory companies are not weighted in any way.
- Note: Where the percentages for a chart are calculated on bases fewer than 50 respondents these must not be reported as they do not represent a wide enough cross-section of the target population to be considered statistically reliable. These questions and figures will be italicised.

Sponsor this survey

- The QCA/YouGov Sentiment Survey has been running since 2011 and is an established source of information about the small and mid-sized quoted company sector and the advisory firms that work in this space.
- Opportunities are available to sponsor future editions of this survey. The survey runs twice a year and options are available to sponsor either single editions or for extended periods (e.g. two years/four surveys)
- The survey is distributed to an audience of over 5000 individuals working in the small and mid-sized quoted company space – including the companies themselves, advisors (investors, brokers, NOMADs, lawyers, accountants) as well as regulators and policymakers.
- The survey runs with a set number of fixed repeated questions and then a number of different topical questions in each wave. As sponsor, you can help decide these topical questions and so ask the questions to which you want the answers.
- For more information, please contact QCA Head of Operations, Hayley Zeff (hayley.zeff@theqca.com / 0207 397 8142).

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