MOORE STEPHENS

Strength amidst uncertainty in 2017

The real estate and construction sector view

Owner managed businesses

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Contents

Survey background

To gather the data for this report, we conducted an online survey of around 700 owner managed businesses between 10 November and 16 December 2016. The findings within this whitepaper represent the views of 80 real estate and construction respondents – primarily chief executives, managing directors or partners, owners of their businesses.

Foreword

Cautious optimism continues to be the dominant mood among owner managed businesses (OMBs) operating in the real estate and construction (RE&C) sector.

Our latest annual OMB survey found that for the majority of RE&C businesses, their performance in 2016 was as expected or better, and on the whole they are confident about 2017.

Most OMBs in the sector see plenty of opportunities to bid for new projects and expand their longer-term revenues, but shortages of skilled resource, access to funding and sector regulation including business tax means that many are having to temper their ambitions.

This report highlights the risks, concerns and opportunities that RE&C businesses face when pursuing growth in 2017.

Confidence in 2017

Real estate and construction (RE&C) OMBs are less confident about hitting revenue and profit targets, with 71% expressing confidence about both, compared to 88% and 84% respectively last year. They are also less confident about the general outlook (61%, down from 84%).

On all counts, however, RE&C OMBs are more confident than OMBs overall. This relative confidence is due to the nature of the pipeline for RE&C OMBs. In construction, the majority of the next year's order book will be secured, so they know what to expect for the year ahead.

Paul Fenner, Head of Real Estate & Construction at Moore Stephens, reports that "a lot of businesses felt that although things were improving, they didn't actually see that happening and growth has been slower than expected. There are lots of opportunities in the market, but construction OMBs are struggling to take them on as they haven't got the resources, due to the skills gap, or the funding in place. They are also cautious of overtrading and cash flow problems caused by going after too many projects. So the market continues to be cautious."

We found varying confidence levels among RE&C respondents: smaller businesses (with turnover up to £5m) are more confident than larger ones (turnover above £5m) with combined confidence percentages of 81% and 62% respectively. Just under half (49%) of RE&C respondents expect their business to perform better in 2017 than it did last year, which is substantially less than the 59% of OMBs overall.

For 39% of RE&C OMBs, business performance in 2016 was better than expected (aligned with the 40% of OMBs overall with a better than expected performance). Smaller OMBs did best: 66% performed better than expected (none doing worse), while only 30% of larger businesses did better (and 35% did worse).

RE&C OMBs are more likely than OMBs generally to have already experienced some negative impact arising from the Brexit vote (38% compared to 30% of OMBs overall). This is particularly the case for smaller RE&C OMBs, 44% of which have felt some negative effect. However, seemingly those smaller RE&C OMBs who haven't experienced the negative impact are supporting of Brexit – 56% compared to the larger businesses where only 25% agreed with the decision to leave. Even so, 36% of RE&C OMBs agree with the decision to leave the EU (slightly more than the 32% of OMBs overall).

Fenner says, "The main reason for the negative impact from Brexit is import prices for raw materials increasing as a result of the weak pound sterling. Over 60% of raw materials to the construction industry are imported. Also, a larger proportion of immigrants that work in the construction industry come from Europe."

Confidence in 2017

61%
are confident about hitting revenue and profit targets

49%
expect their business to perform better in 2017

39%
believed their business performed better than expected in 2016

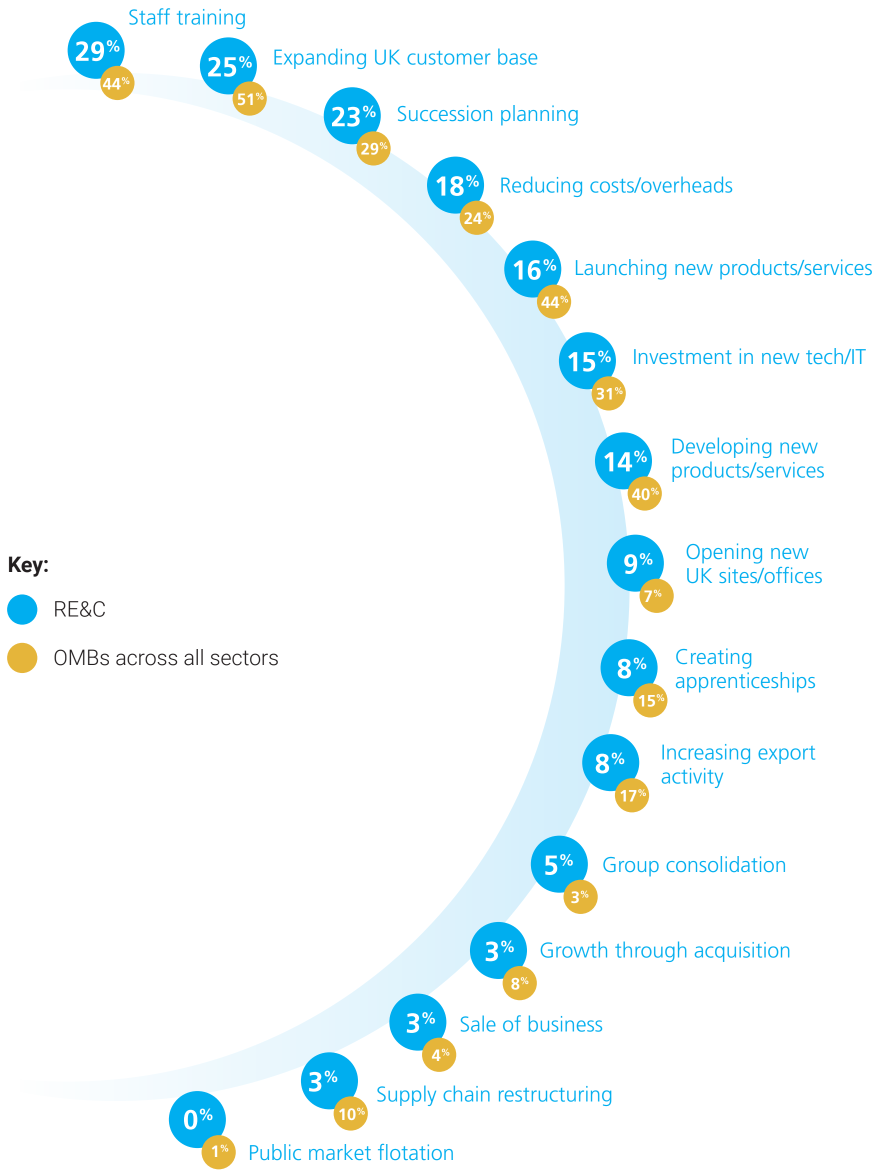
71%
are confident about hitting revenue targets

38%
experienced negative impact from Brexit

Our aspirations are to consolidate the growth achieved in the previous year and to maintain margins within a post Brexit environment.

Guy Barker
UL Knight Roadworks Ltd

Strategies in 2017



Strategies in 2017

Compared with OMBs in general, RE&C OMBs appear relatively unwilling to commit to specific strategies in 2017. For example, the most popular strategy among RE&C OMBs is to invest in staff training (with 29% certain or very likely to do so) – but this falls well below the 44% of all OMBs that plan to invest in training this year. The prioritisation of staff training nevertheless reflects the fact that a shortage of skilled staff is still the RE&C OMBs' top business-related concern.

A quarter of RE&C OMBs are certain or likely to expand their UK customer base – the most popular strategy for OMBs overall (selected by 51%). Given that 90% of the RE&C OMBs we surveyed have no export activity, it's surprising that more aren't looking to increase their UK customer base. The fact they are not planning to do so reflects their reduced optimism this year about the general outlook.

RE&C survey respondents are relatively interested in succession planning, a strategy that 23% are certain or very likely to implement this year. This reflects the fact that 92% of the RE&C OMBs surveyed have at least one business owner aged over 50.

Bringing a succession plan to fruition can take some time, depending on the nature of the business, and the expertise and experience of the management team (or younger family members), as well as their interest in taking over the business.

The availability of finance is a concern for almost one in five RE&C OMBs (18%). Of course, raising funding is particularly challenging in an uncertain economic climate. However, RE&C OMBs could potentially take advantage of Government initiatives such as the Home Building Fund, which offers loans to private sector businesses that build new homes or prepare sites for housing developments. Fenner says: "Only 18% of RE&C OMBs see external funding as a key risk for the year ahead, reflecting the fact that funding will already be in place for a number of projects for next year. OMBs are now looking for funding on 2018 projects and beyond and getting funding is still difficult in construction, particularly on speculative projects. Offshore funding has come through for major UK city projects and there are now alternative funding providers, including an uptake on invoice discounting and peer to peer lending."

Strategies in 2017

Reducing costs and overheads is the fourth most popular strategy among RE&C OMBs (again with 18% certain or very likely to implement it). This reflects the greater uncertainty about the general outlook and ability to achieve profit targets, and may explain why the investment in new technologies and IT as a key business strategy has dropped from 56% last year to 15% this year. Although companies may not be investing in this way for 2017, business owners could be missing out on research and development (R&D) tax credits on the technologies they have already put in place, which could fund future development projects.

Our experience shows that construction companies involved with design and build could potentially claim up to 2% of turnover. The sector remains unaware that its activities falls within the scope of R&D relief available. According to HMRC, only £35 million of tax credits (less than 2%) was claimed by the construction sector compared to total claimed.

Investment in technologies and IT has dropped from **56%** to **15%** this year

Only **2%** of construction companies are claiming R&D tax credits. They could be missing out.

Concerns in 2017

RE&C OMBs have little reticence about identifying the issues that concern them in 2017. When asked about business-related concerns, the shortage of skilled staff tops the list (selected by 46% of RE&C OMBs – a similar result to the 43% of OMBs generally). This is particularly a concern for smaller RE&C OMBs (turnover up to £5m), 56% of which expressed concern about the shortage of skilled staff.

Fenner says: "There is still a skills shortage despite levies paid to CITB (Construction Industry Training Board). Some companies are asking why are they not seeing the benefits of this investment. Other initiatives have been set up, such as BESS (Built Environment for Skills in Schools) encouraging the next generation to take an interest in the construction industry in the hope they might choose a career in it. However, this does not address the shortage we have right now.

"There is also a lot of interest in apprenticeships, in recognition of the value of on-job learning. A number of RE&C OMB businesses would probably prefer to see extra funding to enable more apprenticeships, than corporation tax cuts."

Tax worries also come through strongly. Over a third (35%) of RE&C OMBs are concerned about business tax and 30% are concerned about extracting profits from the business. Profit extraction worries reflect the rise in the dividend tax rate. Small RE&C OMBs are particularly concerned about this issue (67% of those with turnover under £5m). Alongside this, just over a third (34%) of all RE&C OMBs are also concerned about regulation in their sector – revealing slightly higher levels of concern than among OMBs overall (29%).

Vincent Wood, Tax Partner within the Real Estate & Construction team, says: "Businesses are aware the headline corporation tax rates are falling but it is pleasing to see the new Chancellor support that trend. Not so pleasing to business however is the proposed withdrawal of the £5,000 dividend allowance, particularly as the allowance was supposed to be the compensation to taxpayers for the increase in the tax rates on dividend income from 6 April 2016. Now we are just left with the increases. This means maximising tax allowances and credits and careful planning around what business vehicle to use and how to extract profits are more important than ever."

Concerns in 2017

46%
concerned about shortage of staff

35%
concerned about business tax

30%
concerned about extracting profits from the business

34%
concerned about regulation in the sector

68%
concerned about the strength of the UK economy

49%
concerned about the impact of Brexit

Aspirations for 2017

To continue to invest in the business for growth and develop our reach to international markets. Attract and recruit new talent to the business and invest in training and development of existing workforce. To try and maintain profitability in the face of currency headwinds.

Marcus Bentley
Solus Ceramics Ltd

A 20% increase in turnover and corresponding increase in profit to meet or exceed targets in our 3 year plan. To increase our market share and maintain our reputation for quality and innovation within our industry. To be able to reward and retain key staff members and maintain a stable workforce. A decent dividend for the shareholders.

Kevin Weston
SureSet UK Ltd

Advancement in accordance with the business plan -planned and managed growth, in profitable manner, increasing the balance sheet and reserves, thereby enhancing business resilience.

Stephen Shaylor
Shaylor Group PLC

15 ways to build a successful business in 2017

- ☑ Address skills shortage by taking an innovative approach to recruitment, apprenticeships, developing relationships with local schools, colleges and universities. Visit **www.beskillsinschools.co.uk/**
- ☑ Nurture your talent and invest in training and development – people may develop capabilities that enable them to take on more senior roles.
- ☑ Consider whether tax-efficient long-term incentive plans could help you retain key employees in the business, particularly those vulnerable to poaching by competitors.
- ☑ Focus on cash generation – by generating cash you can seize opportunities and invest in your business, without necessarily having to rely on external funders. Up front payments in advance on riskier projects.
- ☑ If you do seek external finance, shop around and consider all the funding routes open to you, from asset-based lenders to peer-to-peer and crowdfunding platforms.
- ☑ Target quality customers and build strong relationships with them – such customers will support the resilience and growth of your business.
- ☑ Review your supply chain and consider whether any opportunities exist for closer working relationships.
- ☑ Where businesses are problem solving or undertaking innovative projects, look into R&D tax credits to see if your business is eligible to claim. These credits could help you fund future projects and improve margins. They will also help fund and add value on using better technologies on projects to help win tenders and bids.
- ☑ Make your capital expenditure count – don't be led by tax reliefs or incentives but focus on what will increase efficiency, sales, service quality, etc.
- ☑ Invest wisely in technology – cloud-based systems make new technology more affordable and more widely-accessible than ever.
- ☑ Examine your marketing spend: should you be applying it in different ways, perhaps experimenting with digital marketing?
- ☑ Even if you are growing, keep a tight control on costs to maintain your margins.
- ☑ If organic growth is slow or stalled, consider acquiring another business – a competitor, supplier or customer. Return on investment could be higher if due diligence is carried out properly.
- ☑ Be opportunistic and look for ways to diversify your business, e.g. by increasing overseas sales – but plan carefully before trying to enter foreign markets and take professional advice.
- ☑ Be flexible and prepared to change your business strategy if it no longer works – a great strength of OMBs is their ability to make rapid decisions and respond fast to changing market conditions.
- ☑ Don't forget about succession planning – it can take several years to groom an upcoming management team or address internal issues that would put off an external buyer. Think about it now!

Solutions

46% are concerned about the shortage of skilled staff and 29% are likely/certain to undertake staff training

Skills shortages is driving up salaries and putting margins under pressure in this sector; real estate and construction companies could consider alternative remuneration approaches. There are a range of tax approved share schemes that will allow you to incentivise your employees, and ensure they are rewarded for contributing to the success of your business. Our team can help you decide which option is best for your business, assist in the design process and advise on all aspects of valuations, tax implications and employment and capital gains tax treatment.

35% identified the business tax environment as a concern, and sector regulation for 34%

In this challenging economic environment, businesses face pressure to explain their taxaffairs transparently, manage risk and maximise opportunities. We can advise you on a range of areas including maximising capital gains tax and R&D tax reliefs, implementing tax efficient business structures, assisting with tax planning for disposals, and guide you through the requirements of the construction industry scheme (CIS).

25% are very likely / certain to expand their UK customer base

With domestic competition (44%) and the strength of the UK economy (68%) noted as economic concerns for many, expansion in the UK market is an understandable strategy. Our Real Estate & Construction team is in the marketplace every day, and are well established to provide you with expert guidance from investment advice to funding opportunities.

92% of businesses have at least one owner aged over 50

Our Real Estate & Construction team helps clients analyse the options available to them when selling or handing on the reins of their business. We know how much importance OMBs place on the future of their business, and we look to find a strategy that best suits each owner. This may include selling to a competitor, your management team, private equity or passing the business to a family member. We also help our clients get into the best position to sell.

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