

DRAFT BUDGET 2014-15

SUBMISSION FROM THE ENTERPRISE RESEARCH CENTRE

Introduction

SMEs have the potential to play a significant role in driving growth in the UK over the next few years. Maximising this potential requires effective, evidence-based policy and the creation of a business environment which is growth enabling. A key focus of the Enterprise Research Centre (ERC) is to collate and assess the existing evidence-base for SME policy making. While there are several gaps in our knowledge of SME growth, there is also a strong body of evidence that demonstrates the effectiveness of policy in supporting SME growth through innovation and exporting, finance and leadership and management development.

Established in January 2013, the ERC is an independent research centre which aims to provide trusted, robust and independent commentary on SME research and policy. The ERC is a partnership between Warwick and Aston Business Schools in collaboration with Imperial College Business School, Strathclyde Business School and Birmingham Business School. Stephen Roper is Director of ERC, Mark Hart is Deputy Director. ERC funding is provided by the Economic and Social Research Council, the Department for Business, Innovation & Skills, the Technology Strategy Board and, through the British Bankers Association, by the Royal Bank of Scotland plc, HSBC Bank plc, Barclays Bank plc and Lloyds TSB Bank plc.

This submission is drawn from a summary of the ERC's six thematic White Papers published in April 2013 and covers key issues affecting SMEs in the UK economy, coupled with work undertaken within Scotland by Professor Sara Carter (Associate Director of ERC) with regard to growing the diversity of Scotland's entrepreneurial population.

Growth and rebalancing

Growth is a key policy objective but what kinds of firms create most growth? The ERC White Paper by Anyadike-Danes et al. (2013) provides some of the answers, and also highlights some outstanding areas of uncertainty. Their analysis suggests some striking stylised facts. First, the majority of jobs in the UK are created by small firms (i.e. less than 50 employees and including micro-enterprises). As a result, smaller firms have been increasing their share of total employment year on year and in 2010 their share of employment was triple that of 1998. Second, the profile of job creation and destruction is relatively stable over time - even the economic downturn after 2008 did not affect the overall scale of job creation and destruction taking place in the UK economy. Third, although definitional differences make a significant difference to apparent outcomes, high growth firms and larger non-high growth SMEs are most prolific in terms of job creation. Fourth, despite this evidence the 'brutal facts' of UK business demography mean that around 75% of firms which start small stay small, and over a decade around 75-80% of new firms will close.

Two of these stylised facts are worthy of particular emphasis in thinking about UK growth. The increase in the importance of small firms as a provider of jobs emphasises the importance of the SMEs in the future growth of the UK economy.

Secondly, the stability of the profile of job creation and destruction through time emphasises the difficulty of developing policy initiatives which are powerful enough to enhance (or perhaps counter) the market processes which drive business demography. This is a council of realism not despair, however, as internationally differences in business demographics – including the role of high growth firms – are evident (Anyadike-Danes et al. 2013). Policy initiatives which change the business environment can have significant effects on growth intentions and business growth (Levie, 2013). Where market failures can be established targeted policy initiatives may also have significant value. As Carter et al (2013) point out, for example, ethnic minority owned businesses (EMBs) constitute around 8% of the small firm population in general but this figure rises significantly in the main urban areas, notably London, Birmingham, Manchester and Leeds. In these areas effective measures to support the growth of EMB businesses are likely to have a disproportionate impact on business demographics and growth outcomes.

Gaps in our understanding of business demographics remain, however. In particular we know little about the pace of job creation at the firm-level. For example, we don't yet know whether there is any uniformity in the performance of the very small group of extraordinarily prolific job creators; nor whether there are any firms not in that group which would have been had we interrogated the data at some other time horizon. Next steps in the ERC research programme will investigate the growth trajectories of firms – tracking their employment history from birth to (say) age ten, because from such trajectories we can map directly into job creation.

Localism

Moves towards more localised policy design and delivery have been emphasised by the recent City Deals and the Heseltine Review. Potential growth gains here are evident in a number of areas. The potential for local co-operation is, for example, illustrated in Lockett et al (2013) in the context of management skills and dynamic capabilities. Based on the importance of leadership skills and dynamic capabilities Lockett et al illustrate the potential for national measures such as the Growth Accelerator to be augmented by locally implemented programmes such as the Warwick Business Innovation and Growth Programme and Goldman Sachs 10,000 Small Businesses Programme. Such programmes – as well potentially as local innovation voucher type programmes – can help to create the inter-organizational knowledge sharing networks that serve as inputs into evolving dynamic capabilities. Clearly there is scope to create equivalent programmes linking Scottish universities and the private sector in supporting a broader swathe of the Scottish SME sector than can be offered by the existing, successful account-managed approaches of SE and HIE.

Evidence reviewed by Love and Roper (2013) also emphasises the contribution of local business eco-systems and partnering to both SME innovation and export performance. This creates the potential for localised policy initiatives which can help form or strengthen local partnerships to boost SME competitiveness. Such initiatives may also be important in helping to tailor support initiatives to the specific needs of local businesses, perhaps particularly those led by women or members of ethnic minorities. While we know that the evidence base on the need or justification for such specific interventions is often weak, there is some evidence to suggest that a range of support delivery, including that targeted at specific groups, can be highly

beneficial both at the early start-up stages and also in linking specific business owning groups with public and private procurement opportunities.

Growing the diversity of Scotland's entrepreneurial population

The draft framework on Women in Enterprise in Scotland, currently out for consultation, highlights the considerable concern that the low rates of participation by women in entrepreneurship constitute a major 'gap'. Women's enterprise can be difficult to precisely define and enumerate, but it is estimated that around 21% of Scotland's 339,000 SMEs are majority-led by women and a further 22% are equally-led by women and men. Men are still almost twice as likely to start businesses as women.

While the under-representation of women in entrepreneurship is an international concern, relative to other high income countries, Scotland's rates of female business ownership are persistently low. The scale of Scotland's enterprise 'gap' is illustrated by estimates suggesting that Scotland would have an additional 108,480 businesses if women's business ownership rates equalled those of men. This would equate to a 32% increase in Scotland's business base.

The contribution of women-led businesses to the Scottish economy is substantial. Estimates suggest that women-led businesses contribute (at a minimum) £5 billion GVA. If rates of women-led businesses equalled those of men, the contribution to Scotland's GVA would increase by £7.6 billion to nearly £13 billion. This equates to 5.3% growth in the size of the Scottish economy.

Among women-owned businesses in Scotland, there is considerable ambition and growth aspiration. A survey by Women's Enterprise Scotland in 2012 found that 87% were planning growth and 27% wanted to grow rapidly. Notably, women owned businesses – as well as ethnic minority owned businesses - perceive higher levels of difficulty accessing finance.

Entrepreneurial finance

Discussion of funding gaps for growing businesses in the UK is longstanding, a discussion intensified during the financial crisis. In recent years, loan rejection rates have increased sharply and discouragement has increased. Early-stage venture capital funding also remains at a low level (Fraser et al. 2013). Issues relating to business finance vary significantly, however, within the SME population. EMBs, for example, while not facing direct discrimination, do experience worse credit outcomes due primarily to standard risk factors (e.g. age of business, financial track records) (Carter et al. 2013). Women owned businesses, are similarly more likely to be discouraged borrowers, and while there is no evidence of bank discrimination there is clear evidence of higher levels of debt-avoidance among women that constrains business growth. In this regard there are obvious training implications both for women entrepreneurs and for the institutions and agencies offering business support.

Alternative forms of financing such as crowd-funding may be useful but are used by few SMEs due to lack of: availability, awareness, financial expertise and confidence in being able to obtain these sources of funding. Trade credit also provides an alternative form of funding and may also be helpful in playing a signalling role as

firms using trade credit may gain greater access to bank credit. Policy too can play a valuable role in stimulating a net increase in the availability of finance as evidenced by recent studies of the Small Firms Loan Guarantee and its successor the EFG (Fraser et al., 2013).

Given evidence that funding gaps appear to be larger, and growth weaker, in the UK relative to other major economies, and that there is also longstanding evidence that there is insufficient long term finance for UK SMEs, recent proposals for the development of the UK Business Bank seem helpful. International experience provides some best practice in the design and delivery of such support from examples such as KfW in Germany, the Small Business Administration in the US, and even fast growing emerging market counterparts such as the Small Industries Development Bank of India. It is also useful that the Business Bank proposals include consideration of aligning financial assistance and business advice along the lines of the 'one-stop shop approach' taken by both KfW and SBA. This may go some way to dealing with the awareness issues which seem to be a major constraint on existing policies (Fraser et al. 2013).

The ERC White Papers highlight a number of areas in which our understanding of the contribution of entrepreneurial finance to growth remains limited. Points about entrepreneurial cognition and its effects on the demand for finance and investment have already been highlighted. The White Papers also emphasise the need for a more detailed understanding of how financiers can assist entrepreneurs to orchestrate their financial and other resources to generate sustainable growth. The potential benefits are not just limited to the increases in productive capacity and employment. Capital investment also plays important role in enabling other strategically important business activities such as innovation and exporting as the evidence in Love and Roper (2013) suggests.

Skills and business leadership

The ERC white papers suggest a clear picture of the contribution of entrepreneurial leadership to SME growth and some of the continuing gaps in our understanding. Levie (2013) emphasises the positive and statistically robust link between business leaders' growth ambition and subsequent growth. But what determines growth intention or ambition? Here, the evidence at the level of the individual entrepreneur is rather confused with experience, education and more psychological factors all playing a part. Stronger evidence suggests the importance of the business and regulatory climate justifying a continued UK focus on regulatory reform particularly in terms of employment regulation. Growth intentions are a function of beliefs concerning the desirability and feasibility of achieving growth goals. These beliefs are a joint function of personal, organizational and environmental factors

Given any level of growth ambition, the ability of a leadership team to deliver on growth by developing appropriate dynamic capabilities depends on domain knowledge and entrepreneurial experience (Lockett et al. 2013). Prior entrepreneurial experience allows entrepreneurs to develop broader and more complex mental models which allow them to "connect the dots" between seemingly disparate information. The nature and diversity of knowledge among the entrepreneurial leadership team also has a positive bearing on growth, both directly and indirectly via opportunity identification. Growth ambition may also lead SMEs to

set specific, challenging goals. Evidence suggests that such goals result in higher performance than vague and/or easy goals (given adequate commitment, feedback and knowledge).

Developing dynamic growth capabilities requires capable management. However, resource constraints mean that SMEs tend to invest less in management development than larger organizations. There is evidence that SMEs often lag behind best practice because owners and managers of SMEs are unable or unwilling to make the necessary investments of time or resources. Public intervention – such as the Growth Accelerator or Companies of Scale Scheme - may be justified to help SMEs overcome such resource constraints. Measures to support supply chain development may be important in indirectly promote capability building in SMEs (Lockett et al. 2013). Similarly – where market failure can be established – measures to support leadership development and ‘breakout’ in EMBs may also be a high priority in some areas (Carter et al. 2013).

ERC next steps

Over the next three years the ERC will be conducting research intended to address the gaps in the evidence base. The Centre also aims to build a bridge between existing evidence and on-going SME issues. These issues may relate to national or regional policy or the activities of other SME facing organisations. More details on the ERC work programme and the six published White Papers can be found at www.enterpriseresearch.ac.uk.

ERC White Papers

Levie, J (2013) ‘Growth and growth intentions- a meta-analysis of existing evidence’, Enterprise Research Centre White Paper 1.

Lockett, A Hayton, J Ucbasaran, D, Mole, K and Hodgkinson, G (2013) ‘Entrepreneurial Leadership, Capabilities and Growth: A review of existing evidence’, Enterprise Research Centre White Paper 2.

Carter, S Ram, M Trhan, K and Jones, T (2013) ‘Diversity and SMEs: Existing Evidence and Policy Tensions’, Enterprise Research Centre White Paper 3.

Fraser, S Bhaumik, S and Wright, M (2013) ‘What Do We Know About The Relationship Between Entrepreneurial Finance and Growth?’, Enterprise Research Centre White Paper 4.

Love, J and Roper, S (2013) ‘SME innovation, exporting and growth – a review of existing evidence’, Enterprise Research Centre White Paper 5.

Anyadike-Danes, M Hart, M and Du, J (2013) ‘Firm Dynamics and Job Creation in the UK: Taking Stock and Developing New Perspectives’, Enterprise Research Centre White Paper 6.