DRAFT BUDGET 2014-15

SUBMISSION FROM THE ENTREPRENEURIAL EXCHANGE

Introduction

The Entrepreneurial Exchange welcomes the opportunity to contribute to the work of the Committee on the Scottish Government draft budget 2014-2015 with particular focus on support for **growth companies, growth sectors and growth markets**. With some 400 members comprising entrepreneurs at all stages of business growth and having collective revenues of over £14 billion and 150,000 employees, we are uniquely positioned to comment from the perspective of the business that is committed to growth.

We are focused solely on ambitious, growth oriented entrepreneurs. We exist to provide opportunities for our members to meet like-minded individuals, to share experiences of growing a business – good and bad. We are neither sector nor industry specific – we believe that every business shares the same generic growing pains, people, sales, finance, strategies for growth and so on.

We pioneered the celebration of entrepreneurial success in Scotland with the launch of the Entrepreneurial Exchange Entrepreneur of the Year awards in 1995 and our Hall of Fame is a veritable "who's who" of wealth creation in Scotland.

We are not a lobbying organisation, we leave that to others. We have a core team of three full time equivalent employees and a part time chief executive and possess no deep research facilities. Nevertheless, we believe that we have sufficient anecdotal evidence from years of events focused on growing businesses to make a contribution to the enquiry.

Business growth or aspiration?

An initial study into growing businesses in Scotland was carried out in the early/mid 1990s by Alan Wilson of SCDI and, amongst other findings, concluded that the difference between high growth and low growth companies in Scotland was that high growth companies wanted to grow. This seemingly simple fact is as true today as it was then. Businesses cannot be made to grow – they have to consciously choose to grow.

Various definitions of business growth have been used, particularly within the economic development bodies but to a certain extent these miss the point. The key to business growth in our experience is the level of ambition or aspiration of the entrepreneur or business owner – and this can change in the right circumstances.

Growing a business of substance or scale is difficult – very difficult – but there are plenty of role models who have achieved it. Some are well known and have achieved considerable public profile whilst others have eluded the media spotlight but are still willing to share their experiences and encourage and support others.

Furthermore, we have seen a number of examples where our members have an ambition to grow a business to a certain size but by networking and learning from those who have built businesses of scale have changed their aspirations substantially. Perhaps it is a matter of confidence, perhaps something else but it can have a dramatic effect on the prospects for their businesses and the wider economy.

Where is business growth coming from in Scotland?
We believe that over the last decade the environment for business growth in Scotland has improved immeasurably, notwithstanding challenging economic conditions. Success is lauded, not frowned upon. Honest failure is something to be tolerated and learned from. The media in Scotland has played its part in this but from time to time reverts to sensationalist reporting, mainly with reference to the remuneration of business owners, who seem to be vilified for extracting some of the rewards of their hard work.

Nevertheless, we have come a long way and there is much to take pride in, but it is now time to raise the game. So who are the new wealth creators – the individuals and their organisations that should be the focus of an economic development strategy with growth companies, growth sectors and growth markets at its heart.

They will not be found in the massed ranks of new starts. Relatively few entrepreneurs have the ambition and mind-set to grow a business of substance and fewer still have the opportunity to dominate their market.

We believe that there are, broadly speaking, two potential sources of business growth – technology companies and non-technology companies.

Technology companies
The attraction of encouraging growth oriented technology companies in Scotland is well understood with much of the infrastructure in place to support growth.

However, there have been few success stories so far. It would appear that this is a long term game taking 10 years at least and in relative terms creates fewer jobs, albeit of high value. The reality is that the successful technology company will probably not reach its full potential and be subject to a trade sale. Why is this?

Often the technology company is no more than a product looking for a marketplace with insufficient management talent. Sales traction is hard to achieve and companies spend too much time in the funding pipeline, seeking investment on a sustained basis from the business angel and venture capital communities.

In the absence of a pipeline of successful listed technology companies, such as Optos and Wolfson, media commentary has often focused on the sell-out, from OWL and Spider to Atlantech, Award, MTEM and Voxar. We do not believe that these examples necessarily demonstrate a lack of ambition; rather they reflect a certain pragmatism when faced with the reality of growing a global sales operation from a Scottish base against the might of a well-funded international competitor.

The significant advantage that the successful exit can bring is an increase in the experience base – at executive and non-executive level – that can be applied to the next generation of technology companies. The impact that the individuals that started and grew the aforementioned companies have had on Scottish technology companies and on government policy should not be underestimated. Their time and wealth has been leveraged to great effect – but we need more. The strength of Silicon Valley, Route 128 in Boston and in the UK, Cambridge, is their critical mass of technology companies – large and small - which allows for the transfer of management talent and the attraction of competition in the venture capital markets. Scotland is not there yet.

What Scotland does have is many of the building blocks – the infrastructure referred to above – and what is needed now is a concerted effort to attract the necessary management talent (particularly in sales) to make the most of the opportunities that are emerging. There are some signs of this happening (this area is one of the areas of focus of the current MIT REAP work) but increased momentum is required. Similarly, in the absence of a competitive venture capital market in Scotland, the business angel community (with the support of Scottish Investment Bank) has filled a gap and now provides the necessary access to funding for the growing technology company. However, there is increasing evidence of a significant disconnect in the funding journey of a high growth technology company with tensions between angel investors and venture capitalists perhaps limiting the ability of companies to grow and leading to exits at too early a stage. Both the MIT REAP team and the Royal Society of Edinburgh are examining this issue at present.

Non -technology companies

Turning to non-technology companies we face a completely different set of issues and our comments are based on observation and experience of the Exchange membership.

Here we are describing existing (not new start) companies who have successfully moved past survival and have been trading for a number of years with a solid management team in place. Such a business is less likely to be unique, will have its customer base closer to home with limited international potential, but is probably a reasonably significant local employer. In all likelihood the sales skills are already there but after a number of years of moderate growth the company has stabilised. However, there is the opportunity to use this solid platform to build the business and provide significant employment potential.

Scotland has many such companies if the Insider 500 and Insider Enterprise 250 lists are anything to go by. However, the growth rates of these companies seem relatively weak, particularly outwith oil and gas sector. As ever, there are notable exceptions such as Alexander Dennis, John Wood Group, Clyde Blowers, City Refrigeration, Simon Howie Foods, National Tyres and Scott Timber but why are there not more?

In a successful business there is perhaps an element of becoming too comfortable and after years of hard work and risk taking it is not unreasonable that the founders take some time to enjoy the fruits of their labour. How can these businesses be encouraged to start taking risks again and to go for growth? Even if the owner can be persuaded to put the hours back in why would they risk the wealth that has been created in the business? Can it be protected or perhaps partially extracted to avoid “betting the ranch” on this new growth strategy?

Even if these very personal issues can be resolved how realistic is it to expect the current management team to be able to tackle the new challenges facing them?

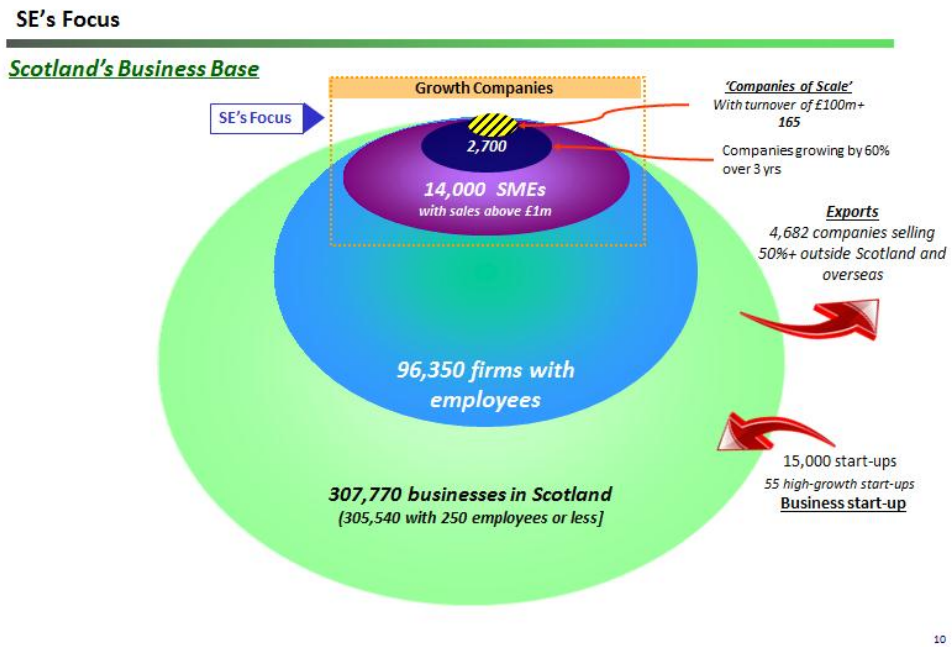
Typical constraints include:
- Scalability of service vs product (esp business services)
- Lack of experience in building the brand
- Lack of experience in multi-site operations
- Lack of experience in making acquisitions
- Lack of international ambition and experience

Additionally, financing a growth strategy is likely to require development capital but this often means planning for an exit to provide the investor their required return which might undermine the gains for the economy of Scotland.

Once again however there are role models in Scotland who can inspire others and help them overcome these challenges.

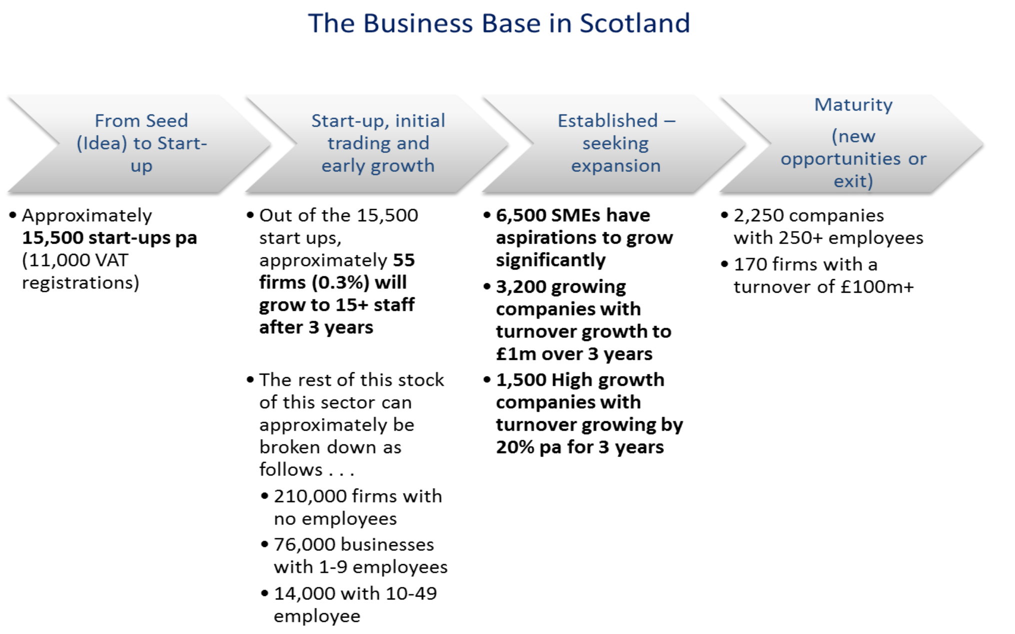
So what?
The reason for providing some detail on the realities of growth is that there needs to be much more honesty about the make-up of the business base in Scotland and therefore where scarce resources should be directed to give Scotland the best return on its investment in the economy.

The term SME is so broad as to be meaningless and it is therefore difficult not only to focus actions to support growth but to measure the impact of those actions. More detailed analysis of the business base in Scotland has been carried out by both Scottish Enterprise as part of its own business planning and the Secretary of State for Scotland's Business Base Scotland Group. Both analyses highlight the relatively small number of growth companies in Scotland.



Source: Scottish Enterprise Business Plan 2013-16 Stakeholder Presentation
The chart above states:

- 307,770 businesses in Scotland, 305,540 with 250 employees or less
- 96,350 firms with employees
- 14,000 SMEs with sales above £1 million
- 2,700 companies growing by 60% over 3 years
- 165 companies of scale – with turnover of £100 million plus
- 4,682 companies selling 50% plus outside Scotland and overseas
- 15,000 business start-ups with 55 high-growth start-ups



Source: Scotland Office Business Base Scotland Group
The above chart states:

- approximately 15,500 business start-ups with 11,000 VAT registrations
- out of the 15,500 start-ups approximately 55 firms (0.3%) will grow to 15 plus staff after 3 years. The remainder is broken down: 210,000 firms with no employees; 76,000 businesses with 1-9 employees; 14,000 with 10-49 employees
- 6,500 SMEs have aspirations to grow significantly
- 3,200 growing companies with turnover growth to £1 million over 3 years
- 1,500 high growth companies with turnover growing by 20% per annum for 3 years
- 2,550 companies with 250 plus employees
- 170 firms with a turnover of £100 million plus

As noted above the issues facing growing companies are well established and our experience is that economic development support from Scottish Enterprise, Highlands and Islands Enterprise and Business Gateway has been very effectively refined to address these issues. This is of course subject to being “inside the system” and being account managed but again the processes of each of the organisations have been improved to identify the ambitious high growth or high growth potential business.

Access to finance
One significant area which is common to both technology and non-technology growth companies is **access to finance** and this is the one area we would like to discuss with the committee during this process. Unless ferociously well managed in terms of working capital so that growth is self-funded, every growth business will require additional funding as it grows and there needs to be a good supply of relevant sources of funding to help these businesses.

In your call for evidence you presented the following:

EET areas of interest
Access to finance, particularly for SMEs

Relevant Purpose Targets
Economic growth: To raise the GDP growth rate to the UK level by 2011
Economic growth: To match the GDP growth rate of the small independent EU countries by 2017

Relevant National Indicators
Increase the number of businesses
Increase exports

Our first comment is that the reference to SMEs requires to be refined. The latest research contained in the report SME Access to Finance 2012 – Scottish Government clearly distinguishes between the demand for finance from micro businesses and those employing more than 10. There appears to be little evidence that the micro businesses of Scotland (the overwhelming majority of the business base) want to grow and it is therefore not surprising that there is a relative lack of demand. The analysis needs to be focused on the narrower group of growth businesses and drilled down to the demand/supply of specific types of growth finance. As an example, we are surprised that since the launch of the Scottish Loan Fund in February 2011 until 31 March 2013 there were only ten deals totalling £18 million from a total fund size of £113 million (£55 million coming from Scottish Investment Bank). Is there no demand or is there an issue with the product?

A second comment in relation to the table is that the relevant national indicator is likewise too broad. Simply increasing the number of businesses who do not then grow will not substantially alter the economic growth rate. We would recommend that this level of analysis is again deepened to segment and measure the performance of growth businesses, perhaps split between knowledge based/technology growth companies and non-technology companies. We are certain this level of granularity at the firm level is already being measured by the economic development bodies.

The ongoing Scotland Office Business Base Scotland Group work on Access to Finance and the Business Growth Journey is attempting to map out the funding landscape in Scotland and the UK as a whole and is feeding into the Finance Hub as part of the Scottish Business Portal. In addition the MIT REAP work is also looking at access to finance and we would recommend that EETC ensures that there is close collaboration between each of these working groups and that there is a single consistent approach and that this is fed into the forthcoming Entrepreneurship and Innovation Framework.

We have several specific matters relating to access to finance which we would be happy to expand on during the oral evidence session.

Summary
In summary you asked the following questions:

• What progress has the Scottish Government made in delivering its overarching purpose - focus Scottish Government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth - through its spending decisions over the last two years and in relation to NPF targets and indicators?
Very significant progress has been made in focusing the work of the economic development bodies to identify ambitious growth businesses and provide relevant support to those who genuinely want to grow and to create wealth and employment in Scotland. However, there has been too much promotion of start-up and programmes to support start-ups and the official support and profiling of real growth companies needs to be improved.

• Is the NPF an effective method of measuring performance and are sufficient resources being allocated to track progress against the targets and indicators?
Our comments above refer – need to perform deeper and more segmented analysis to identify growth companies and measure their performance.

• How should resources allocated to the economy, energy and tourism portfolio in the draft 2014-15 budget be applied to support these core areas of interest and NPF targets and indicators and achieve long-term economic growth?
Increased focus on ambitious growth companies.

• What alternative spend would you propose to better support each core area of interest and from what area should such resources be diverted?
We look forward to expanding on our comments and recommendations in discussion with the Committee.