

BRITISH ENTERPRISE IN TRANSITION

The Centre for Business Research (CBR) at Cambridge University is an interdisciplinary research institute with the study of Small and Medium-sized Enterprises as one of its core programmes. The biennial SME surveys carried out by the CBR are widely regarded as the most authoritative examination of this key element of the UK economy.

British Enterprise in Transition is the fourth report to be published on the basis of those surveys. The first published was the highly acclaimed State of British Enterprise report in 1992. The firms included were re-surveyed in 1995 with a special emphasis on their innovation activity and the results published in a second report in 1996 as The Changing State of British Enterprise. A new panel of over 2,500 firms was surveyed in 1997 and the results were published in the third CBR report Enterprise Britain. The current fourth report re-surveys these firms.

Comments on previous CBR Survey Reports

'The particular value of the Cambridge research lies in the number of enterprises questioned - more than 2,000 in both manufacturing and service sectors from through-out Britain. It should provide a valuable source of material for organisations which provide services to business and policy-makers in both the private and public sectors.'

The Financial Times

'The most comprehensive survey of Britain's small and medium-sized firms (SMEs) since the Bolton inquiry.'

The Guardian

'...A mine of information and will serve as a valuable benchmark for future researchers...offers a unique perspective on the SME sector in the UK'.

International Small Business Journal

'...A particularly stimulating report to read...All specialists in the small firms area will want a copy'.

International Journal of Industrial Organisation

'The survey analysis is meticulous and professional...Like all good research which is neutral and fact-based it will provide ammunition for all sides of the debate on what is a complex subject'.

Small Business Perspective

'By quizzing a panel of 2,000 companies every two years, the CBR has built up an authoritative, comprehensive and up-to-date profile of this sector of the British economy'.

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Contents

Acknowledgements	1
Definitions	2
CHAPTER ONE Survival, Size, Age and Growth <i>Anna Bullock, Andy Cosh and Alan Hughes</i>	3
CHAPTER TWO Training, Human Resource Management Methods and the National Minimum Wage <i>Michael Kitson and Frank Wilkinson</i>	4
CHAPTER THREE Markets, Competition and Collaboration <i>Michael Kitson and Frank Wilkinson</i>	5
CHAPTER FOUR CEOs, Management Structure, Growth Objectives and Constraints <i>Andy Cosh and Alan Hughes</i>	7
CHAPTER FIVE Profitability and Finance in UK SMEs <i>Andy Cosh and Alan Hughes</i>	9
CHAPTER SIX Innovation Activity and Performance in UK SMEs <i>Andy Cosh and Alan Hughes</i>	11
CHAPTER SEVEN The Growth and Performance of Small High-Tech Firms in the UK Economy <i>Alan Hughes and Barry Moore</i>	13
CHAPTER EIGHT External Advice and Business Link <i>Robert Bennett and Paul Robson</i>	14
CHAPTER NINE North-South and Urban-Rural Differences in SME Performance and Behaviour <i>David Keeble</i>	15

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Andy Cosh and Alan Hughes
Editors

Definitions

Types of Business

- Micro - Businesses with less than 10 employees in 1996/97.
- Small - Businesses with between 10 and 99 employees in 1996/97.
- Medium - Businesses with between 100 and 499 employees in 1996/97.
- Newer - Businesses formed in 1986 or later.
- Older - Businesses formed in 1985 or earlier.
- Manufacturing - All manufacturing industries (SIC(1992)).
- Services - Advertising, Management, Technical and Professional Consultancy and Telecoms Services (SIC (1992) principally industry headings 64.11-64.20, 72.20-72.60, 73.10-73.20, 74.12-74.50, 74.81-74.84).
- Stable/Declining - Businesses with zero or negative employment growth during last two years.
- Medium growth - Businesses with employment growth greater than 0% and less than 30% during last two years.
- Fast growth - Businesses with employment growth of 30% or greater during last two years.
- Innovators - Firms which introduced an innovation during last two years.
- Non-innovators - Firms which did not introduce any innovations during last two years.
- Survey period - June-August 1999
- Response rate - 60%

Chapter 1 - Survival, Size, Age and Growth

Anna Bullock, Andy Cosh and Alan Hughes

- The macroeconomic environment leading up to the 1999 survey had been favourable, but there were concerns about the high value of the pound and the prospect of rising interest rates.
- The firms which had been acquired since the 1997 survey were significantly larger, but the opposite was true for the failed firms.
- Comparing the respondents with non-respondents as a whole, the only significant difference was their average age. It was otherwise difficult to discriminate between the two groups suggesting little bias in this data.
- No particular changes in industrial composition were observed in this panel of firms.
- There is some evidence of more rapid growth in turnover in the services sector and of declining employment in larger firms where manufacturing is more strongly represented.
- There has been a decline in employment growth rates between 1994-97 and 1997-99.
- A few growers account for the vast majority of total employment growth in the sample.
- In general innovation helps employment growth and exports.
- Perhaps not surprisingly, in view of the strength of sterling between 1997 and 1999, exports have not grown much, but nor have they decreased much.
- Exports tend to be generated by manufacturing firms.

Chapter 2 - Training, Human Resource Management Methods and the National Minimum Wage

Michael Kitson and Frank Wilkinson

- Fewer than 50% of all firms provided formal training in 1999, a proportion which was 10 percentage points lower than two years before. The decline was much greater in manufacturing than in services.
- Of the firms which provided full training information for both years, 54% provided the same level of training, 20% were providing more and 26% were providing less in 1999 than in 1997.
- The decline in the number of firms that train was greatest amongst firms which had spent relatively little on training.
- Older, larger, growing and innovating firms included a higher proportion of trainers than newer, smaller, stable or declining and non-innovating firms, and the general tendency was for training to decline most where firms trained least.
- The categories of businesses which train more also have a higher proportion of firms with a relatively large proportion of total labour costs dedicated to formal training.
- 40% of the businesses used job rotation and multi-skilling, 34% quality management and 31% had performance related pay.
- Use of these HRM was more prevalent in manufacturing, large, older, growing and innovating firms.
- Very few firms had reduced the use of HRM and a sizeable proportion had increased it. The categories of firms using HRM most intensively are taking the lead in increasing its use.
- More firms practicing HRM provided formal training and HRM firms which trained spent more on training.
- 78% of the firms had no employees on the national minimum wage, 9% had less than 50% of their employees on the NMW (low NMW intensive) and 13% had more than 50% employees paid NMW (high NMW intensive).
- There is no clear pattern of NMW intensity across the different categories of firms.
- A higher proportion of the low NMW intensive firms used HRM methods than either of the high NMW intensive firms or firms with no minimum wage workers.
- Low NMW intensive firms were more active trainers than those without minimum wage workers but high-NMW intensive firms trained least.

Chapter 3 - Markets, Competition and Collaboration

Michael Kitson and Frank Wilkinson

- In general the firms in the survey, particularly small firms, rely on relatively few customers: 66% of firms depend on their largest five customers to provide at least a quarter of their business.
- There is a lack of extensive competition facing most firms in the sample: 75 % of firms had less than 10 serious competitors; 49% had less than 5 serious competitors and 15% believe that they have no serious competitors.
- The lack of competition is greater for smaller firms: 80% of micro firms had less than 10 serious competitors compared to 73% of small firms and 66% of medium-sized firms; also, 23% of micro firms had no serious competitors.
- Non-innovating firms are more likely to have less than 10 serious competitors compared to innovating firms.
- In general, the apparent lack of competition has increased since 1997.
- The smaller the firm the greater the likelihood that its competitors will be larger: 52% of micro firms and 31% of small firms compete exclusively with larger businesses, compared to only 17% of medium-sized firms.
- The extent of foreign competition faced by the firms in the survey is limited: 63% of the firms believed that they did not have any serious overseas competitors.
- The extent of foreign competition is greater for manufacturing firms and it also increases with firm size.
- Stable and declining firms and medium growth firms are more likely to face foreign competition compared to fast growing firms - this may reflect the impact of an overvalued exchange rate on the growth performance of firms competing in international markets.
- Innovating firms are more likely to face foreign competition: 44% of innovating firms had serious overseas competitors compared with only 22% of non-innovating firms.
- The extent of foreign competition in 1999 was consistently greater than the level in 1997 for all categories of firms.
- More than a third of the firms in the sample had entered into formal or informal collaborative partnership during the previous two years.
- Collaborative agreements were more widely used in the business services sector than in manufacturing, reflecting the importance of networking in the business services sector.
- The likelihood of entering into a collaborative arrangement increases with firm size - 29% of micro firms enter partnership agreements compared with 39% of small firms and 57% of larger firms.
- The stable and declining group show the least propensity to collaborate with others although the medium growth group show a greater propensity than the fast growth group to enter such partnership arrangements.
- Newer firms are more likely to enter into collaborative arrangements than older firms.
- Innovating firms are also more likely to enter into collaborative agreements: 46% of the innovating firms entered into partnership arrangements compared with only 22% of non-innovating firms.
- The 1999 survey shows a 5 percentage point increase in collaborative activity compared with 1997.
- The most common collaborative partners were firms in similar areas, customers and suppliers.

- Business services firms are more likely to collaborate with firms in similar lines of business whereas forward and backward linkages are more important for manufacturing firms (as is collaboration with higher education establishments).
- Innovating firms are more likely to use vertical linkages compared to non-innovating firms. Additionally, innovating firms are almost three times more likely than non-innovating firms to enter into partnership with higher education establishments.
- The pattern of collaboration with different partners in 1999 shows no statistically significant differences with the pattern in 1997.
- Firms in the survey undertook collaboration for a range of reasons. The four most important in 1999 and 1997 were to help expand the range of expertise and products, to assist in the development of specialist services and products required by customers, to provide access to UK markets and to improve financial market credibility.
- In general, innovating firms are more likely to collaborate for all reasons compared to non-innovating firms. The one exception in 1999 was to help keep current customers and the exception in 1997 was to assist in management and staff development.
- The survey did not reveal a dominant model of the location of collaborative partners - although collaboration with partners who were located nationally was the biggest group.
- The National Minimum Wage (NMW) had no impact on the competitive strategies of most NMW paying firms in the survey.
- For those firms where it did have an impact, the NMW tended to result in increased, rather than decreased, emphasis on factors to improve competitiveness in the product market.
- The evidence in this chapter illustrates the complexity of markets and competition. Additionally, it shows that the collaboration process is complex: it is undertaken for a wide range of reasons and with a range of partners in a variety of locations. Understanding, more fully, the interactions between collaboration and competition is important in analysing the competitive process and constructing appropriate policies to improve competitiveness.

Chapter 4 - CEOs, Management Structure, Growth Objectives and Constraints

Andy Cosh and Alan Hughes

- The CEO (or managing partner, or proprietor) had been with the business for 17 years on average with 14 years as CEO.
- Medium-sized and older firms operating in manufacturing have CEOs with the longest service with their firms.
- CEOs in medium-sized firms spent seven years on average with the business before becoming the CEO.
- Older, larger, slower growing and manufacturing firms have older CEOs.
- Only 8% of the sample firms had female CEOs in 1999 and these were more likely to be found in newer, micro and services firms.
- About half of our CEOs retained control of both strategic and operating decisions.
- This personal control of decisions is more likely to be found in newer, micro, non-innovating and services firms.
- The degree of personal control exerted by the CEO is influenced by the legal form of organisation chosen by the firm.
- About half of the sample firms have no formal structure for their management organisation.
- These informal structures are more common amongst newer, non-innovating, micro firms in services. They are also more common where the CEO has direct personal control over decisions.
- When account is taken of both the size and age of the firm we find that size is the principal determinant of the formality of the management structure.
- More formal structures for the management organisation are also associated with more sophisticated management practices in relation to investment appraisal and human resource management.
- In 1999 the sample firms had lower growth ambitions for the next three years than they had in 1997.
- The growth experience of the firms over the last two years reflected to some extent their ambitions in 1997 - but it was easier to achieve modest ambitions.
- Their growth ambitions in 1999 were significantly affected by their recent growth experience.
- Medium-sized, newer and innovative firms are more ambitious in their growth targets.
- Firms with more formal management structures and greater delegation are more likely to seek to grow substantially; and this is not a size effect.
- Increasing competition remains the perceived greatest limitation on the attainment of business objectives.
- Demand factors appear to be rising in importance as limitations, whilst financial constraints are easing.
- Fast growth firms are more concerned about supply side limitations.
- Micro firms no longer score the financial constraint higher than other size groups.

Chapter 5 - Profitability and Finance in UK SMEs

Andy Cosh and Alan Hughes

- The median profit margin for the sample in 1999 was 10.5%, a modest fall from the level in 1997 for this group of firms.
- Profit margins were found to be significantly higher for micro and service sector firms - results which match those of our earlier surveys.
- The higher profitability of service sector firms in our sample is not a size effect since service sector firms were significantly more profitable than manufacturing firms within the micro size group.
- Non-innovators also continue to be found to be more profitable than innovators.
- 466 (39%) of our sample firms sought about £189m of new finance and obtained about 90% of this.
- 47% of our sample did not seek external finance in either 1995-97 or 1997-99, but 23% sought external funds in both periods.
- On average, the amount of external finance sought approximately equalled the level of capital expenditure carried out by the sample firms which sought external finance. Those not seeking external finance carried out lower capital expenditure.
- Older firms sought more external finance on average and were more successful in obtaining it than newer firms.
- Innovators and growing firms are more likely to seek external finance. They also seek more, but are not significantly more successful in obtaining it than non-innovators and stable/declining firms.
- Larger firms are more likely to seek external finance, they seek larger amounts (absolutely, but not relative to their capital expenditure), and are more likely to obtain it than smaller firms.
- Less profitable firms, which have less internally generated finance, seek more external finance and their success in obtaining it is not significantly different from their more profitable counterparts.
- Banks and HP/leasing firms remain the most often approached sources, approached by 84% and 46% respectively of those seeking finance.
- All sources of finance other than banks were approached by a lower proportion of firms seeking finance in 1997-99 than 1995-97. The resurgence of bank finance was associated with a reduction in the diversity of SME finance.
- Venture capital firms, trade customers and private individuals were approached by less than 10% of SMEs.
- Factoring and venture capital exhibit higher failure rates (in the sense of our firms raising no money from them when approached) than all other sources.
- Micro firms are less likely to approach HP/leasing finance and exhibit higher failure rates across most sources of finance.
- Micro firms are significantly more likely to approach private individuals for external finance and medium-sized are more likely to approach venture capitalists.
- Of those who sought finance about three-quarters received bank finance and about half obtained HP/leasing finance.

- Banks and HP/leasing firms now provide over 80% of the total finance obtained, and within this the importance of the banks has increased dramatically over the last two years.
- No other source provides more than 5% of the total finance raised.
- Venture capital support rises with firm size but the opposite is true for support from private individuals.
- Less profitable firms gain less bank and HP/leasing support but greater support from venture capital, trade customers and factoring.
- Manufacturing firms use a lower proportion of bank finance and make more use of HP/leasing finance.
- Innovators are significantly more reliant on HP/leasing finance and less on bank finance than their non-innovating counterparts.
- There has been a significant return to bank finance over these two years within the SME sector, particularly amongst the micro firms.

Chapter 6 - Innovation Activity and Performance in UK SMEs

Andy Cosh and Alan Hughes

- Acquired firms in the period 1997-99 were more likely to have innovated in the period 1994-97 than those firms which remained independent.
- There is a higher proportion of R&D active firms in manufacturing compared with services; older compared with newer, medium compared with micro, medium compared with small, small compared to micro and innovators compared with non-innovators.
- The relationship with growth is non-linear rising from stable/declining to medium growth and falling from medium to fast growth firms.
- The proportion of firms with a part of their labour force engaged part-time or full-time in R&D was higher in manufacturing than in services; amongst older compared with newer firms; and not surprisingly amongst innovators compared to non-innovators.
- There was a steady upward gradient in the proportion with R&D employment as firm size rises.
- The link between employment in R&D and growth was an inverted U-shape with medium growth firms more likely to have R&D employees than either stable/declining or fast growth firms.
- There has been a significant relative reduction in part-time R&D employment as the proportion of firms reporting R&D activity has fallen.
- The ratio of all R&D staff to total employment fell from 1997 to 1999, and was higher in both years in micro firms, in stable/declining compared to medium growth firms, in newer firms, and in innovating firms.
- The R&D/Sales ratio in the sample as a whole fell from 2.9% to 1.6% in 1999, and in the manufacturing, older, small, innovating and non-innovating and stable/declining groups.
- Manufacturing firms had significantly higher R&D/Sales ratios than service firms in both 1997 and 1999 and innovating firms were more R&D/Sales intensive in both years than non-innovators.
- Micro firms were more R&D/Sales intensive than their comparison groups in 1999 but were significantly less R&D/Sales intensive than medium sized firms in 1997. There was a similar reversal for stable/declining and medium growth firms between those years.
- Around 54% of the sample reported a product innovation in the period 1994-99 and around half of that proportion reported a novel product innovation. Product innovation was significantly more prevalent in manufacturing and small and medium sized SMEs, and amongst medium and fast growth firms. Novel product innovation displayed the same pattern of relationship with size and growth.
- The proportion of firms reporting process innovations was lower than for product innovations, and the proportion reporting novel process innovations was lower still.
- The introduction of logistics innovations was, at 12.5%, least likely to be reported, with novel logistics innovation reported by less than 4% of firms.
- The pattern of relative innovation activity across the groups in 1994-97 was essentially the same as that for 1997-99.
- Both the level, and the pattern, of recent past innovation are very similar to that of future innovation intentions.

- The proportion of 'persistent' innovators was significantly higher amongst older compared to newer; small and medium sized firms compared to micro firms; and medium and fast growth firms compared to stable/declining firms.
- For all sample firms around 7.4% of sales in 1999 were accounted for by recently introduced new products. This proportion was lower in stable/declining firms compared to medium growers, in micro firms compared to small and medium SMEs, and in services compared to manufacturing.
- Past innovation intensity (measured as the percentage of sales accounted for by new products in 1997) is positively related to 1997-99 growth in our sample.
- Median profit margins gradually fell between 1997 and 1999 for both high- and low-innovation intensive groups.
- The median rate of fall of profit margins was significantly different between the low- and high-innovation intensity firms in the medium size group where high-innovation intensity in 1997 had a positive relative impact on the change in profit margins 1997-99. In all other subgroups innovation intensity appeared to have no significant impact on subsequent changes in profit margins.

Chapter 7 - The Growth and Performance of Small High-Tech Firms in the UK Economy

Alan Hughes and Barry Moore

- SMEs in high-tech industries face similar numbers of serious competitors but higher numbers of serious overseas competitors to those facing firms in conventional industries.
- SMEs in high-tech industries face a higher proportion of serious overseas competition than SMEs in conventional industries.
- The number and proportions of serious overseas competitors rose between 1997 and 1999 for SMEs in both conventional and high-tech manufacturing industries.
- SMEs in high-tech industries in both manufacturing and services are more likely to rely on a single large customer for 50% or more of their sales, than do SMEs in conventional industries.
- SMEs in high-tech industries in both manufacturing and services are more likely to have entered into collaborative partnerships than SMEs in conventional industries. Such partnerships increased in frequency for all but firms in conventional services industries in the period 1997-99.
- SMEs in high-tech manufacturing industries are more likely to enter into partnership arrangements with customers than firms in conventional manufacturing industries and the frequency of such collaboration rose in high-tech manufacturing industries in the period 1997-99.
- SMEs in high-tech service industries are more likely to collaborate to share R&D than firms in conventional service industries.
- SMEs in high-tech manufacturing industries are more likely to collaborate to develop specialist products than firms in conventional manufacturing industries.
- SMEs in high-tech industries are more likely to experience losses than SMEs in conventional industries but there are no statistically significant differences in growth rates or in profit margins on sales.
- SMEs in high-tech service industries face greater constraints from a lack of marketing and sales skills than firms in conventional service industries.
- In general the pattern of constraints facing SMEs in high-tech and conventional industries is similar. Both groups reported a decline in the propensity to be constrained by lack of availability or cost of finance for expansion.
- SMEs in high-tech sectors experienced similar success rates in obtaining the finance they sought as SMEs in conventional industries.

Chapter 8 - External Advice and Business Link

Robert Bennett and Paul Robson

- Accountants and banks and the private sector as a whole remain the most used sources of external business advice.
- Business Link has become the fourth most used source of advice, used by 28.0% of the survey panel of respondents, (although some of this high use may reflect the branding of partners' services).
- There is little evidence of a general pattern of close localisation of advice within the supply chain. The mean distance between respondents and their advisors who are suppliers is 82.8 km, and who are customers is 75.4 km (excluding a large number of overseas customers and suppliers).
- The most localised advisors are public sector bodies and chambers of commerce (13.7 km). Local enterprise agencies are 20.3 km and BL 19.6 km from clients.
- General business advice remains by far the most commonly used BL service with 56.7% of users.
- 37.3% of users of BL services were charged a fee.
- There are few statistically significant relationships between being charged a fee and the characteristics of the firm.
- The average number of BL users who are satisfied has increased from 69.3% in 1997 to 82.6% in 1999, although this is inflated by self-selection and possibly by sample attrition effects.
- There is little systematic relation between the characteristics of an SME and the satisfaction level it receives from BL.
- Only four BL services fail to achieve the DTI 80% satisfaction targets for the panel sample: diagnostic assessment (74.1%), sales and marketing advice (78.0%), finance and accounting advice (70.0%), and grants (74.3%).
- The significantly declining level of satisfaction with BL finance and accounting advice should be a cause of concern.

Chapter 9 - North-South and Urban-Rural Differences in SME Performance and Behaviour

David Keeble

- There are significant regional variations in the sectoral, size and age structure of the surveyed SMEs. The Industrial Heartland (West Midlands, North West, Yorkshire and Humberside) sample is dominated by manufacturing firms, and its businesses tend to be older and larger than SMEs elsewhere. The South East sample has the highest share of business and professional service enterprises, and is characterised by high labour productivity. Peripheral (Scottish, Welsh and Northern England) SMEs tend to be younger and smaller.
- Urban-rural variations in these characteristics are less marked. But rural firms are significantly smaller than conurbation firms, while small town firms contain a somewhat higher proportion of manufacturing enterprises.
- The rural group of firms contains a significantly larger proportion of stable or declining enterprises compared for example to large town firms but because of wide variations in growth rates within regional and urban groupings there are no significant differences in employment or turnover growth rates across regions or urban/rural groups.
- There is a significant difference in SME profitability between South East firms and those in the Industrial Heartland.
- South East and Industrial Heartland SMEs are significantly more likely to export than firms in the Peripheral regions of Scotland, Wales and Northern England. A distinctive minority of Peripheral firms are however exceptionally export-oriented.
- A significantly higher proportion of both Peripheral and South East firms wish to achieve "substantial growth" over the next three years. This suggests the possibility, at least, of faster Peripheral SME growth during the early years of the 21st century. However, fewer rural firms are planning for "substantial growth" than urban firms, again suggesting diminished rural SME dynamism.
- There are no significant regional or urban-rural differences in innovation rates. Again, this is in line with the thesis of relatively diminished rural SME dynamism in the late 1990s, compared with the 1980s.
- Scottish, Welsh and Northern firms are significantly less likely to engage in R&D than firms elsewhere in Britain, but the minority that do seem to invest in it particularly heavily, suggesting that these Peripheral regions contain a minority of particularly technologically-focussed SMEs.
- There is a south-north gradient in the intensity of constraints on SMEs because of skilled labour shortages with South East firms significantly more constrained than their counterparts in the Industrial Heartland or the Periphery. Labour constraints appear to have intensified in the South East relative to the North since 1997. Industrial Heartland SMEs report the greatest constraints because of poor growth of market demand.

- SMEs in the South East appear to be facing a significantly fiercer competitive environment than those in Outer Southern England region, as measured by numbers of serious competitors. Conurbation firms also report much fiercer competition than their counterparts in rural areas.
- South East firms also reveal a somewhat higher propensity to engage in collaborative and networking relationships than SMEs elsewhere. There is a striking south-north gradient in frequency of collaboration with universities and higher education institutes, with Peripheral region SMEs being twice as likely to collaborate with universities than their counterparts in the South East.
- There is a remarkable and systematic north-south gradient in SME use of business advice from Enterprise Agencies, Training and Enterprise Councils, and Regional Agencies, with far higher proportions of Scottish, Welsh and Northern England firms accessing such advice than South East SMEs.
- A significantly higher proportion of SMEs in the West Midlands, North West and Yorkshire report using advice from DTI-sponsored Business Link agencies and local Chambers of Commerce than firms elsewhere. Peripheral region firms however make the least use of such advice.
- There is no urban-rural variation in frequency of use of Business Links, while Chambers of Commerce appear to have become somewhat more effective in providing advisory services to rural and small town SMEs between 1997 and 1999.

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