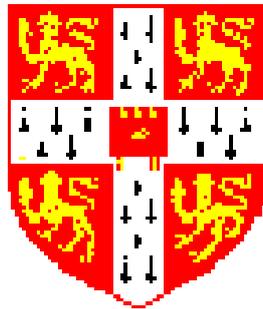


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The State of British Enterprise:  
growth, innovation and competitive  
advantage in small and  
medium-size firms

Executive Summary of  
Key Findings

This paper arises from the research programme into the Determinants of the Birth, Growth and Survival of Small Businesses at the Small Business Research Centre (SBRC), Cambridge University. The SBRC consists of an interdisciplinary group of researchers drawn from three University Departments, Applied Economics, Geography, Land Economy, and the Judge Institute of Management Studies. The Centre is supported under the ESRC Small Firms Initiative by contributions from the ESRC, Barclays Bank, Commission of the European Communities (DG XXIII), Department of Employment and the Rural Development Commission. This support is gratefully acknowledged.

## **The State of British Enterprise**

### THE REPORT

The State of British Enterprise: Growth, Innovation and Competitive Advantage In Small and Medium-sized Firms. (Small Business Research Centre, University of Cambridge, 1992)  
ISBN 0 906251 10 9

This Report provides the first coherent, integrated and up-to-date nationwide profile of Britain's small and medium-sized firm sector since the Bolton Inquiry twenty-one years ago. It reports the results of a detailed national stock-take of over 2000 such enterprises, drawn equally from manufacturing and key professional, technical and business service sectors, conducted by the Cambridge SBRC during the Spring and Summer of 1991 in all regions of Great Britain. It contains a host of new and illuminating findings about Britain's small and medium-sized enterprises, their origins, development and competitive performance. It highlights the problems they experience, their views on and experience of government policies, and their role in technological change and innovation. It charts their growth, the nature of their customers and competitors, and the importance of the skills, training and quality of their workers in their competitive success. It assesses their financial performance and profitability, and documents the surprising frequency of takeovers and acquisition activity amongst Britain's SME population. It throws new light on the individual entrepreneurs and business leaders whose activities are crucial to successful SME development. It identifies important locational differences in SME characteristics within Britain, both between North and South and between the country's big cities and small towns or rural areas. Throughout, it systematically differentiates its findings in terms of enterprises of different sizes, sectors, ages, and rates of growth.

The study has been written and organised so as to be as accessible and 'user friendly' as possible, not just to academics and policy makers, but to all who are interested in the current state of Britain's small and medium-sized enterprises. It is designed to be a mine of useful information for reference and assessment of the condition and characteristics of smaller businesses, in particular those which have grown beyond the very small one or two person stage in their development.

The report includes over 120 tables, figures and maps and consists of eight substantive chapters and an appendix describing the sample design, the conduct of the Survey and a comparison of the characteristics of the sample with those of the wider SME population in Britain.

## **Executive Summary of Key Findings**

### **INTRODUCTION**

The Cambridge University Small Business Research Centre (SBRC) report provides the first coherent, integrated and up-to-date nationwide profile of Britain's small and medium sized firm sector since the Bolton inquiry twenty-one years ago. It reports the results of a detailed national stock-take of over 2000 such enterprises, drawn equally from manufacturing and key professional, technical and business service sectors, conducted by the Cambridge SBRC during the Spring and Summer of 1991 in all regions of Great Britain. The Survey reflects the British SME sector in the midst of recession in 1991 but also charts its progress in the three years prior to that. It reveals a host of new and illuminating findings about Britain's small and medium sized enterprises, their origins, development and competitive performance. It highlights the problems they experience, their views on and experience of government policies, and their role in technological change and innovation. It charts their growth, the nature of their customers and competitors, and the importance of the skills, training and quality of their workers in their competitive success. It assesses their financial performance and profitability, and documents the surprising frequency of takeovers and acquisition activity amongst Britain's SME population. It throws new light on the individual entrepreneurs and business leaders whose activities are crucial to successful SME development. It identifies important locational differences in SME characteristics within Britain, both between North and South and between the country's big cities and small towns or rural areas. Throughout, it systematically differentiates its findings in terms of firms of different sizes, sectors, ages, and rates of growth.

## **Sample Characteristics and definitions used in this Summary Report**

Whole Sample	-	2028 independent British Businesses with less than 500 employees in 1990.
	-	The terms business, enterprise and firm are used interchangeably in discussing this sample but the term company is restricted to incorporated businesses only.
Survey Period	-	April - September 1991
Overall Response Rate	-	32.9%

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### **Types of Business**

Micro	-	Businesses with less than 10 employees.
Small	-	Businesses with between 10 and 99 employees.
Medium	-	Businesses with between 100 and 199 employees.
Larger	-	Businesses with between 200 and 499 employees.
Newer	-	Businesses formed in 1980 or later.
Older	-	Businesses formed in 1979 or earlier.
Manufacturing	-	All manufacturing industries (SIC(1980) Orders 2-4).
Services	-	Advertising, Management, Technical and Professional Consultancy Services (SIC (1980) principally industry headings 8360, 8370, 8380, 8394, 8395, 8396).
Stable/ Declining	-	Businesses with zero or negative Employment Growth (1987-90).
Medium Growth	-	Businesses with employment growth greater than 0% and less than 75% (1987-90).
Fast Growth	-	Businesses with employment growth of 75% or greater (1987-90).

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## **WORKFORCE AND TRAINING**

- Most small and medium sized enterprises employ managerial and clerical staff but there is a division between those that additionally employ skilled manual workers and those that employ technologists and higher professional staff. These differences in skills composition partly reflect the contrast between the employment needs of manufacturing and service firms.
- Skilled manual workers and technologists and higher professionals are the key operatives for most companies yet despite the existence of high and persistent unemployment there are significant skills shortages.
- Most firms provide some form of formal training, although a sizeable group, particularly micro firms, do not.
- Reflecting the level of skills shortages, it is skilled manual workers and higher professionals that are most likely to receive formal training.
- This training is not sufficient to overcome the skills gap.
- In terms of the external supply of training resources, small firms use a mixture of public and private sector provision.
- The former is more important for the training of young people and the latter is mainly used for the training of adults.
- There is evidence of some dissatisfaction with the overall availability and quality of external training provision with particular discontent with respect to the provision made by government-sponsored agencies.

## **TECHNOLOGY AND INNOVATION**

- A high proportion of small and medium sized enterprises are undertaking major product and process innovation.
- Younger firms are more likely to have innovated than older firms.
- Innovation increases with size of firm for all types of innovation.
- Innovation and growth of the firm are positively correlated.
- Considerable importance is attached to in-house technological expertise by a majority of firms.
- Faster growing firms are more likely to attach importance to in-house technological expertise.
- The emphasis of research and development is towards new product development rather than services or process development.
- Larger firms tend to carry out systematic research and development into new processes but in other areas very small firm are no less innovatory.
- Nearly a quarter of firms carrying out research and development employed full-time research and development staff.
- Sixty per cent of small firms make use of external sources of technical information in innovating with substantial use made to suppliers and customers.
- Links with universities and higher educational institutes are significant at local and national levels.
- Cost factors are the key constraint limiting the introduction of new technology.

## MARKETS AND COMPETITION

- The firms in the survey sell their products in a wide range of markets, the main customers in order of importance, are manufacturers, other firms and retailers and wholesalers.
- There has been an increase in the volume of subcontract work undertaken by small and medium size enterprises particularly in the service sector.
- Smaller firms (small and micro) are more dependent on subcontract work than larger firms.
- In general the firms in the survey, particularly micro and small firms, depend on relatively few customers and have few competitors.
- The extent of overseas competition is limited, over 70% of the survey considered that they did not have any serious competitors.
- Personal attention to client needs is consistently the most important competitive factor for firms in all sectors and of all sizes.
- Established reputation, the provision of specialised expertise and product quality are also important competitive factors.
- Competitive factors which have a low rating include product design, cost advantage and marketing, and price only has a middle rating.
- Small and medium size enterprises that export attach more importance to produce quality and product design than non-exporters.
- Just under a third of the firms surveyed had entered into formal or informal collaborative or partnership agreements with other organisations during the last three years.
- The largest groups of collaborative partners were suppliers and customers.
- The firms in the survey undertook collaborative arrangements for a range of reasons with the most important being to help expand the range of expertise or products, to assist in the development of specialised services and products and to provide access to UK markets.
- The evidence in this chapter suggests the growing importance for small and medium size enterprises of segmented or niche markets where quality and reputation are more important than price and cost factors.

## **GROWTH OBJECTIVES AND CONSTRAINTS**

- Notwithstanding changing government and banking policies, the most serious constraints on small and medium size enterprise performance reported by survey firms were the availability and cost of finance, including overdraft finance.
- Small and medium sized enterprises are also particularly constrained by a lack of marketing, sales and management skills, and by the availability of skilled labour. This indicates the need for continuing and enhanced Training and Enterprise Council and government policies in these areas.
- Manufacturing firms report greater constraints in more areas than service firms.
- Financial constraints are especially marked with regard to very small firms, newer firms, and fast growth firms. Lack of management skills and shortages of skilled labour are particularly serious constraints for medium-sized and larger small and medium sized enterprises, and for fast-growth firms. These findings suggest that small and medium size enterprise growth is still held back by constraints in these areas, notwithstanding policy initiatives in the 1980s.
- Most firms (64%) reported that their objective was to grow moderately over the next three years, with a significant minority (23%) willing to grow substantially. This suggests considerable potential for growth amongst British small and medium sized enterprises during the 1990s, notwithstanding the current recession.
- The desire to grow was particularly common amongst medium-sized and larger firms, newer firms, and firms which had already achieved moderate or rapid growth in the last three years.
- The use by small and medium sized enterprises of external business advice was most frequent in the areas of taxation and financial management (62% of firms), computer services (48%) marketing, and business strategy (both 30%). These, together with the introduction of new technology (26%) and improved management organisation (25%), are the most important areas which should be targeted for small firm consultancy advice by public sector support agencies.
- The survey reveals that the use of external advice is generally and appreciably less common amongst small enterprises, while its use is particularly frequent among firms which have achieved moderate or substantial growth in recent years. Fast growth firms have made exceptional use of advice on marketing, personnel recruitment, and taxation and financial management.
- The survey evidence supports the view that the use of external advice in these and other areas enables small firms to overcome constraints and grow more effectively.

- The demand for and use of external professional advice by small and medium sized enterprises is increasing quite rapidly, primarily with a view to aiding business growth and competitiveness.
- Finally, the survey shows that a substantial minority of small and medium sized businesses had made use during the previous three years of the Department of Trade and Industry's consultancy-based Enterprise Initiative (33%), with smaller proportions seeking help from Local Enterprise Agencies and the Small Firm Service (both 7%).
- Firms using local Enterprise Agencies tended to be new, fast-growth firms, suggesting that Enterprise Agency advice is particularly helpful in assisting new businesses to grow rapidly. The Small Firms Service was most frequently used by new and very small businesses.
- Firms using Enterprise Initiative consultants were particularly biased towards medium-sized and rapidly-growing businesses, and to manufacturing firms. Again, this could well indicate that consultancy advice is valuable in stimulating greater small and medium size enterprise competitiveness and hence growth.

## **PROFITABILITY, FINANCE AND ACQUISITION ACTIVITY**

- The survey asked firms a range of questions about their financial position and acquisition behaviour.
- The respondents reported declining profit margins especially when measured after the deduction of interest payments.
- About two-thirds had sought additional finance within the previous three years and the vast majority had been successful in obtaining it.
- Banks were the most important source of finance but hire purchase and leasing also played a significant role.
- The level of interest payments amongst our sample has increased in recent years, both absolutely and as a proportion of profits.
- We find some evidence for an increasing diversity of sources of borrowing.
- Exclusive dependence on overdraft facilities is on the decline and fixed interest sources on the increase.
- Most of our sample had overdraft facilities and were more likely to have increased them than reduced them over the previous year.
- We identify a pressure on cash flows caused by increasing delays in payments by customers.
- About one-fifth of our sample had acquired one or more firms in the previous five years and between them had acquired 600 firms.
- We find evidence that this represents an increase in acquisition over the past two decades.
- The main motives for acquisition are found to be the capture of market shares, diversification and economies of scale.
- Looking at our sample firms as bid targets, we find that about one-fifth of the sample had received a bid in the previous five years and that these predominantly came from larger companies.
- The majority of our sample were not in favour of being acquired in the near future, but were much more open-minded about the prospect in the longer term.
- The prospect of capital gains and increased market share were seen as the most important gains from being acquired, with the loss of independence and control identified as the main adverse consequence.

## **OWNERSHIP, BUSINESS LEADERSHIP AND THE SIZE, AGE AND PERFORMANCE OF SMALL AND MEDIUM-SIZED ENTERPRISES**

- The Survey sample consists of 228 independent British Enterprises which in 1990 employed less than 500 workers. The vast majority are companies rather than partnerships or sole proprietorships. In this summary the term enterprise is used to refer to the sample as a whole. The term company is restricted to the corporate form of business.
- The sample is split almost equally between manufacturing enterprises, and enterprises classified to the business services sector.
- A quarter of the sample employed less than 10 workers (micro firms), a half employed between 10 and 99 workers (small firms) and the remaining quarter employed between 100 and 199 and 200 and 499 workers (medium and larger enterprises).
- Fifty per cent of the sample were formed in the 1980s and 28% were formed prior to 1969.
- New Start Ups were the dominant form of business formation in our sample, and nearly 27% of them were associated with the actual or potential unemployment of the business founder.
- Over one third of enterprises founded in the 1980s cited potential or actual unemployment as a motivating factor in their formation.
- Over 80% of business leaders were either the founder of the enterprise or a relative of the founder.
- The typical business leader in our sample was aged between 45 and 49, and had led the business for 8 years usually since its formation.
- The typical sample company board had three directors one of whom had a degree or professional qualification. The proportion was higher for larger companies and business service companies.
- Chief Executives held 50% or more of the stock in 55% of the sample companies. The proportion held was typically higher in newer, faster growing and micro companies. In a substantial number of medium and larger companies Chief Executives held less than 1%.
- Nearly sixty per cent of boards of directors held 100% of their company's stock. Amongst larger small and medium size enterprises one third of the boards held 100%. In around 14% of sample companies the board held less than 50%.
- The median pre tax profits to turnover ratio of the sample enterprises was 7.5% and was higher for micro, fast growing, and service enterprises. Margins fell slightly from 1987-90.

- Thirty eight per cent of sample enterprises had exports in 1990. The proportion rose to 47.5% in the case of manufacturing. Older and medium and larger enterprises were more likely to be exporters.
- Export to sales ratios were highest amongst micro and newer exporting enterprises. The median export to sales ratio of exporters in the sample as a whole was 13.4%.
- Employment growth in percentage terms was highest in micro enterprises with a median growth rate six times higher than for larger small and medium size enterprises.
- The higher percentage growth rate of the micro enterprises translates into a small number of additional jobs per firm which was only one tenth that of larger enterprises.

## **NORTH-SOUTH AND URBAN-RURAL VARIATIONS IN SME CHARACTERISTICS AND PERFORMANCE**

- Locational differences in the characteristics and performance of small and medium- sized enterprises in northern and southern Britain, and in the conurbations, large towns, small towns and rural areas, are most pronounced in the following respects.
- Northern and more rural businesses are characterised by a high proportion of manufacturing firms, whereas a majority of southern and conurbation firm are engaged in the provision of business services.
- Southern firms are more frequently young, new enterprises, set up in the 1980s, while rural and small town firms are also younger than conurbation firms.
- Southern and rural firms are generally also appreciably smaller in size than northern and urban small and medium sized enterprises. Median employment growth rates do not differ between north and south, but there is a consistent urban-rural gradient in employment growth, with most rapid expansion reported by rural firms, and least rapid by conurbation firms.
- Northern firms are more oriented towards subcontracting than southern firms, while rural firm depend more on smaller customers, on their largest customer, and on exports.
- There is a clear and striking urban-rural contrast in small and medium size enterprise ratings of competitive advantages, with rural firms recording the highest ratings across a range of factors, including cost, price, product quality and design, speed of service, and specialised expertise or products. Conurbation firms generally record the lowest ratings. This finding is almost certainly linked to those on faster rural small and medium size enterprise employment growth and innovative activity.
- There are marked differences in workforce skill composition between northern and rural firms on the one hand, and southern and conurbation firms on the other. The former employ significantly higher proportions of semiskilled, unskilled and skilled manual workers, the latter higher proportions of clerical and administrative staff, higher professionals, and technologists, and managers.
- Skill shortages are most frequent in northern Britain and outside the conurbations, and are focused on skilled manual labour. Provision of formal training is also more common amongst firms in these areas.
- Reported small and medium size enterprise growth objectives suggest the possibility of a continued urban-rural employment shift, and perhaps enhanced northern local small and medium size enterprise expansion, in the 1990s.

- Reported constraints on small and medium size enterprise growth reveal slightly greater problems over overdraft finance for northern firms, and over marketing and sales skills for southern firms. Conurbation firms have the highest ratings for problems with marketing and sales skills and implementing new technology, but the lowest for access to finance and skilled labour. Rural firms report the highest scores for constraints associated with skilled labour, management skills and technology acquisition, but have the lowest rating for premises and site constraints.
- Northern small and medium sized enterprises make more frequent use of public sector support agencies than do southern firms, while urban firms make greater use than rural firm of external business advice from private sector firms.
- Southern firm appear to be slightly more innovative than their northern counterparts in introducing new products or services, new supply, storage or distribution systems, and new administrative and office systems. Northern firms are slightly more innovative with respect to adopting new production processes and work practices.
- Urban-rural differences in innovative activity are striking, with appreciably higher innovation rates in rural firms compared with conurbation firms for new products or services, new production processes, new supply and storage systems, and new office systems.
- Rural firms also rate the importance of in-house technological expertise to their competitive success significantly more highly than urban firms, and report appreciably greater frequency of systematic in-house research and development into new products and new process technologies. They also make more frequent use of external sources of technological information. Only with systematic research and development into new services do conurbation firms score highest.
- These findings thus indicate that urban and rural locations do appear to be systematically associated with low and high levels respectively of small and medium size, enterprise innovative activity, research and technological intensity. This is likely to be important reason for the urban-rural employment shift in Britain, and its causes warrant further investigation.

## **FIRMS' ASSESSMENT OF GOVERNMENT POLICY**

- Changes in taxation and improved incentives to invest were perceived to be the most beneficial policy developments for small and medium sized enterprises in the survey.
- Changes in employment law and increased deregulation of markets were perceived to be of less benefit to small and medium sized enterprises.
- Nearly a third of firms responding considered that they received no help from government policy during the last decade.
- The conduct of interest rate policy is perceived to have been the most harmful policy development.
- A second major concern was taxation policy, although many firms reacted favourably to many tax changes over the past ten years, other changes such as increases in value added tax (VAT) and employer's national insurance and the level of the Uniform Business Rate have been less favourably received.
- Concern over the general conduct of economic policy was also prominent.
- An overall evaluation of the positive and negative assessments of government policy indicates small and medium sized enterprises concern over the volatility and level of interest rates and the lack of economic stability.
- The main policy changes that small and medium sized enterprises would like to see in the near future include changes in interest rate and taxation policies and improved investment incentives.

The Cambridge University Small Business Research Centre brings together a group of specialists with the purpose of defining and analyzing all factors which influence the fortunes of small and medium sized business.

The members are drawn from four University of Cambridge departments: Applied Economics, Geography, Land Economy and the Judge Institute of Management Studies.

The unit's core funding is provided jointly by:

- Economic and Social Research Council
- Barclays Bank
- Rural Development Commission
- Department of Employment
- Enterprise Directorate of the European Commission

The centre's primary function is to integrate data on industrial organisation, firm behaviour and organisational change and to apply it to the study of small company creation, growth and development. The purpose is to develop a theoretical framework by which competition can be defined as a dynamic process, to assess the role of small businesses in that process and to analyze the interplay of internal and external influences on industrial and service companies during their life cycles.