

Employment and Small and Medium Sized Enterprises (SMEs) in the UK

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Outline

Introduction

Definitions

Importance of SMEs in the economy and start-ups in the UK economy

Reasons for success and failure in the UK

Entrepreneurship in the UK

Definitions of Small and Medium Sized Enterprises (SMEs)

Two main approaches to defining an SME are:

Quantitative

based upon criteria such as employment, turnover, asset size. These vary by industry and country.

Qualitative

e.g. ownership or the control of the business.

Small firms are largely independent and not mostly owned or directly controlled by larger firms. Other forms of the qualitative approach to defining small firms includes trying to capture the meanings, beliefs and behaviour aspects, including issues facing managers, that distinguish small businesses from large firms.

(see: Glancey and McQuaid, 2000)

European Commission Definition of Small and Medium-Sized Enterprises

	<u>Micro-enterprise</u>	<u>Small</u>	<u>Medium</u>
Number of employees	0-9	10-49	50-249
Maximum Turnover (in million ECU)	-	7	40
Maximum balance-sheet total (in million ECU)	-	5	27

Commission of the European Communities (1996) - 'Commission Recommendation concerning the definition of small and medium-sized enterprises', C(96) 261 final, adopted (Official Journal L107 of 30.4.96, p4).

To be classed as an SME or a micro-enterprise, an enterprise has to satisfy the criteria for the number of employees and one of the two financial criteria, i.e. either the turnover total or the balance sheet total. In addition, it must be independent, which means less than 25% owned by one enterprise (or jointly by several enterprises) falling outside the definition of an SME or a micro-enterprise, whichever may apply. The thresholds for the turnover and the balance sheet total will be adjusted regularly, to take account of changing economic circumstances in Europe (normally every four years).

Importance of SMEs in the economy

In the European Union

- over 20 million small businesses have under 50 employees.
- 40% of all those employed work in them, 66% of these employees work in businesses with less than 10 employees. Medium sized firms account for a further 10% (Commission of the European Communities, 1999).

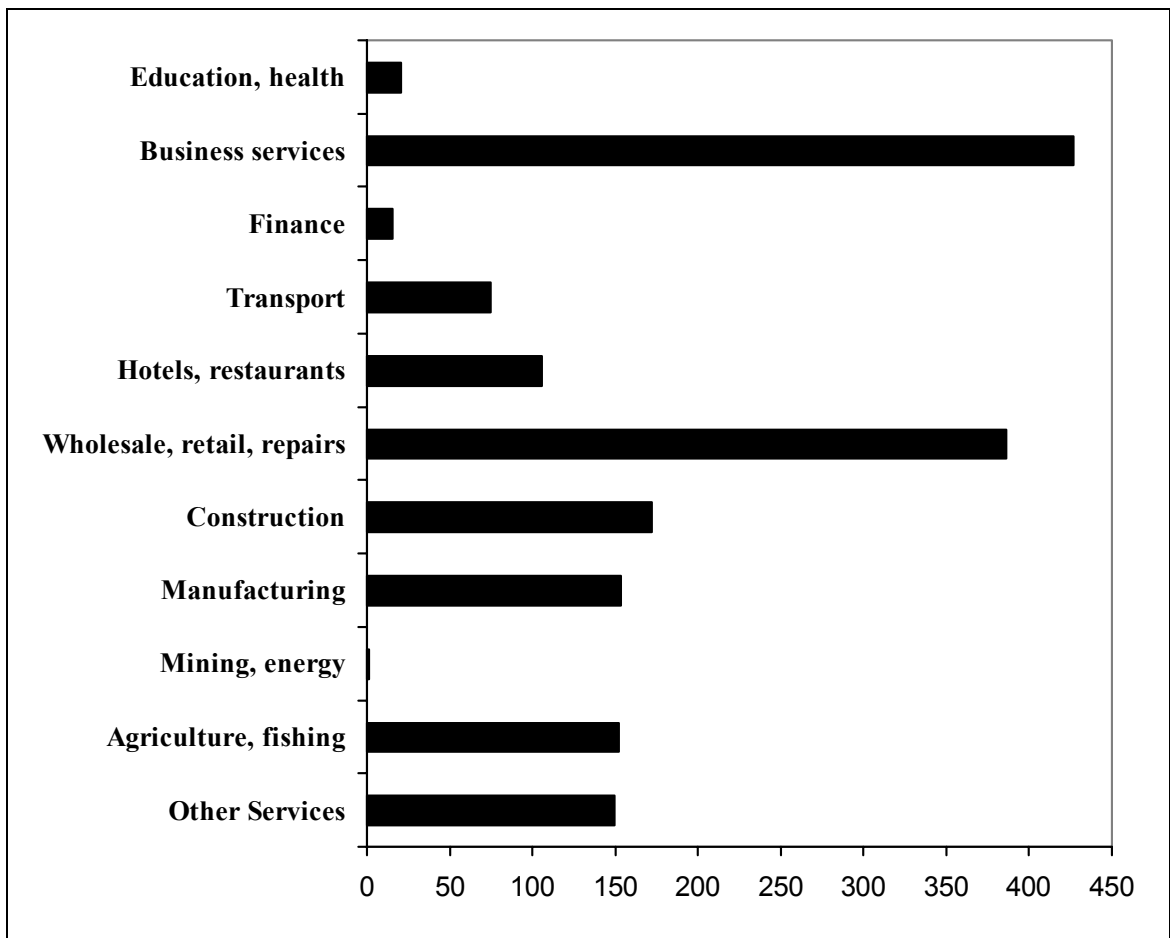
In the UK

- 3.7 million businesses.
- over 2.3 million were 'size class zero' businesses (they have no employees).

SME Share of Businesses, Employment and Turnover (%) UK. (Source: DTI, 2000).

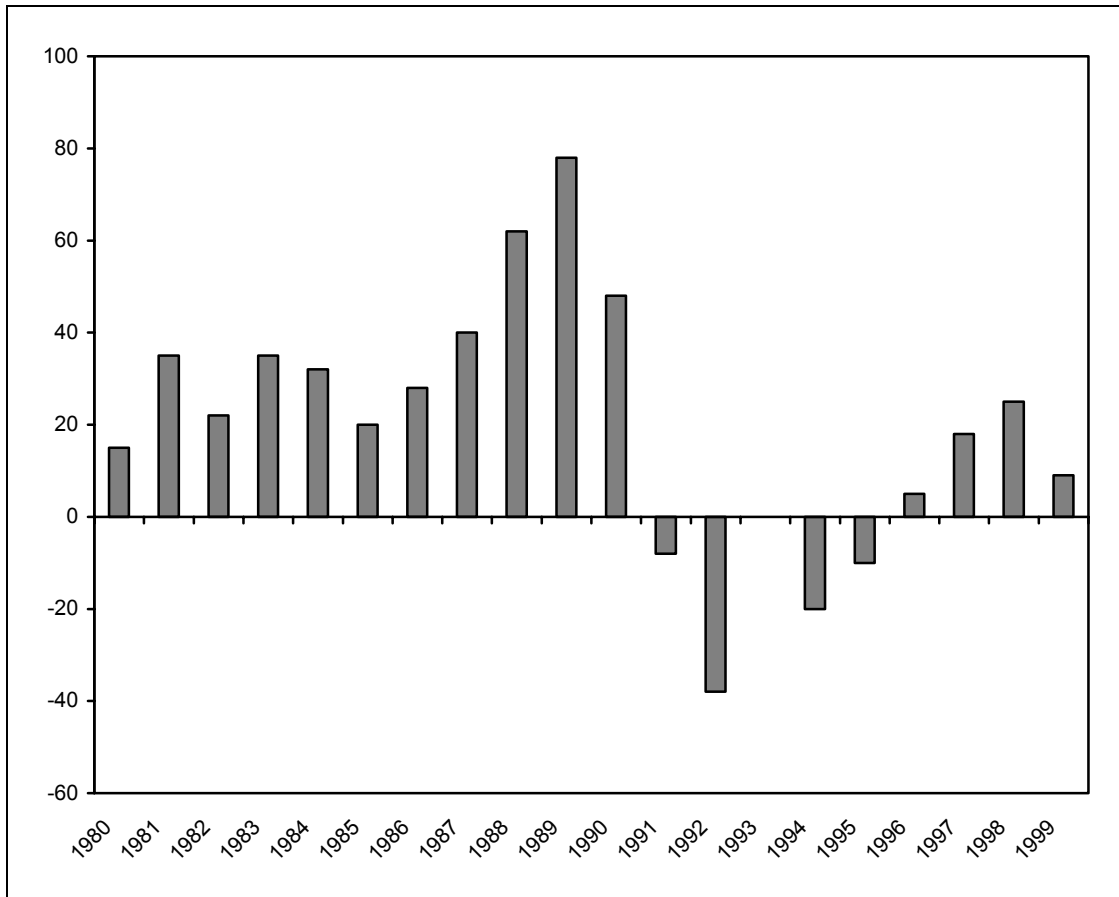
Businesses	Employment	Turnover
99.8	54.1	50.1

UK SME Base by Sector, 2000



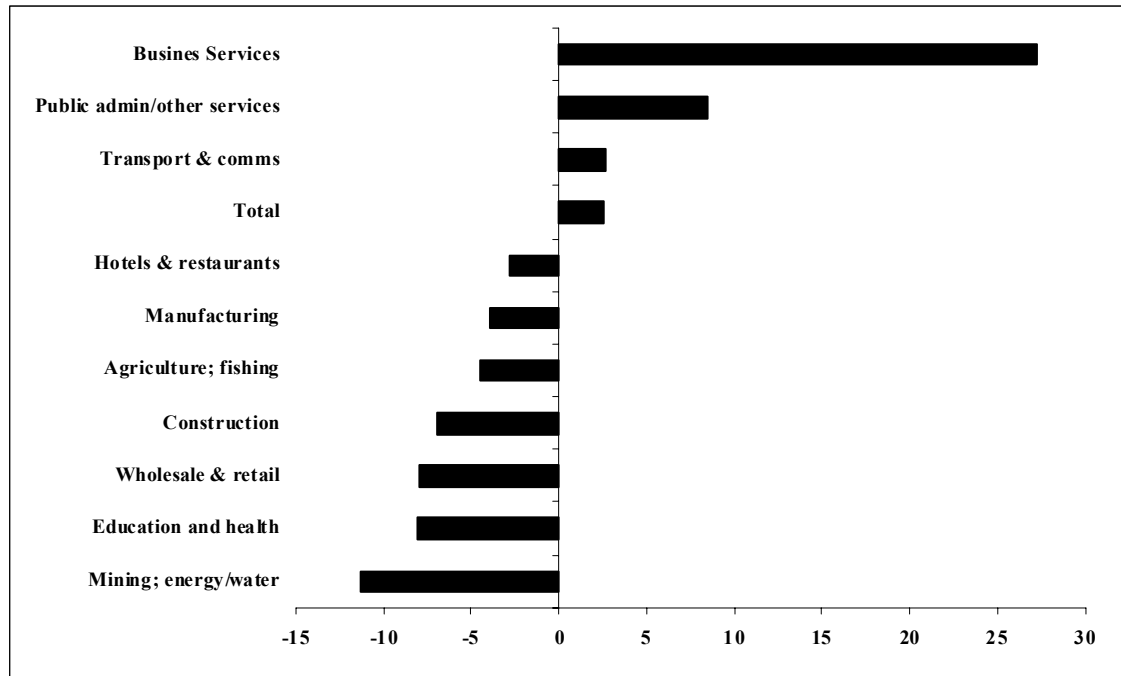
Source: Small Business Service (Research Unit), 2000.

Change in the Stock of VAT Registered Enterprises (Thousands), 1980-1999



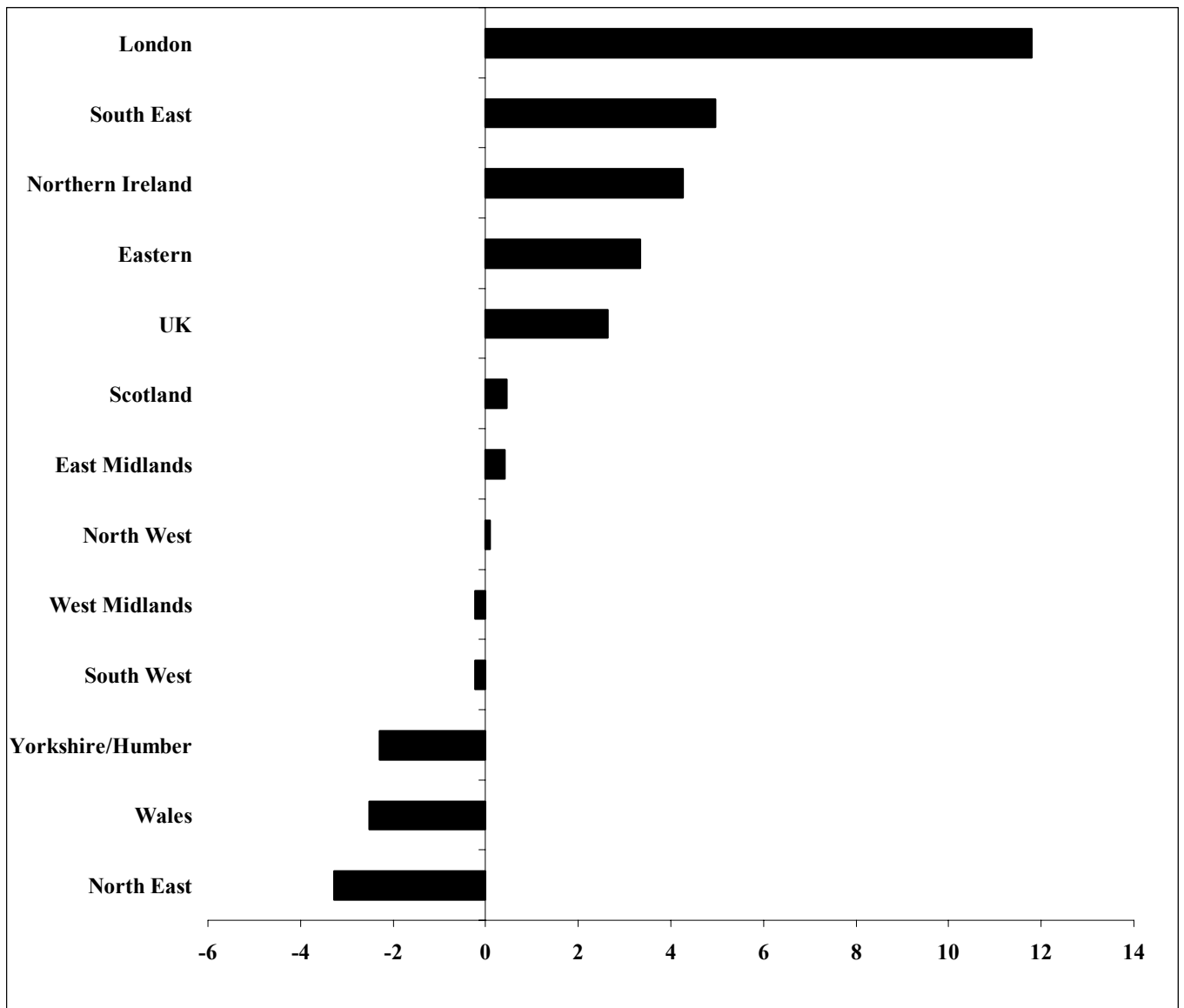
Source: Small Business Service (Research Unit), 2000.

Sectoral Change in Corporate Base, 1995-99 (%)



Source: NOMIS

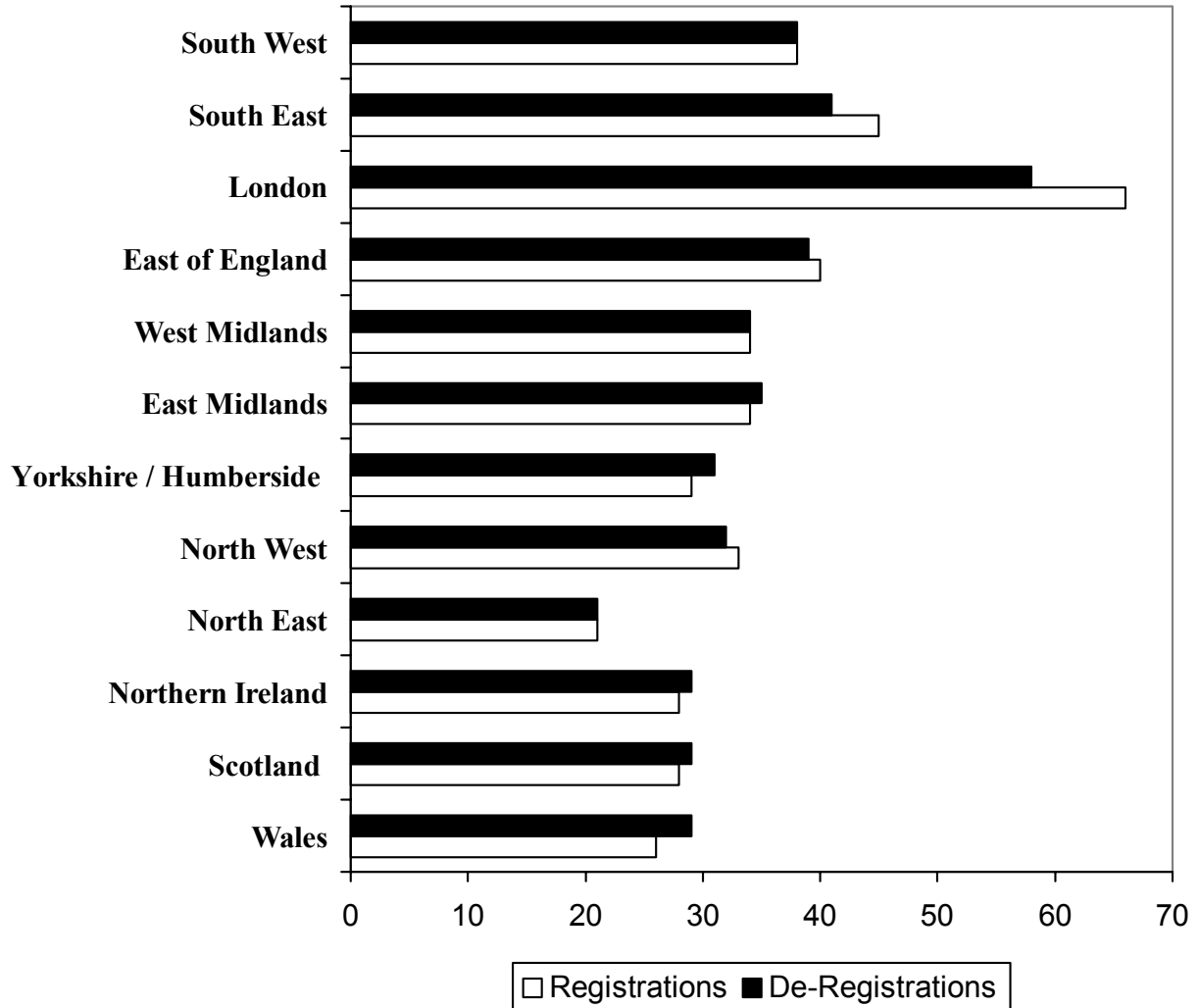
Change in Total Stock of Businesses 1995 – 1999 (%)



Source: NOMIS

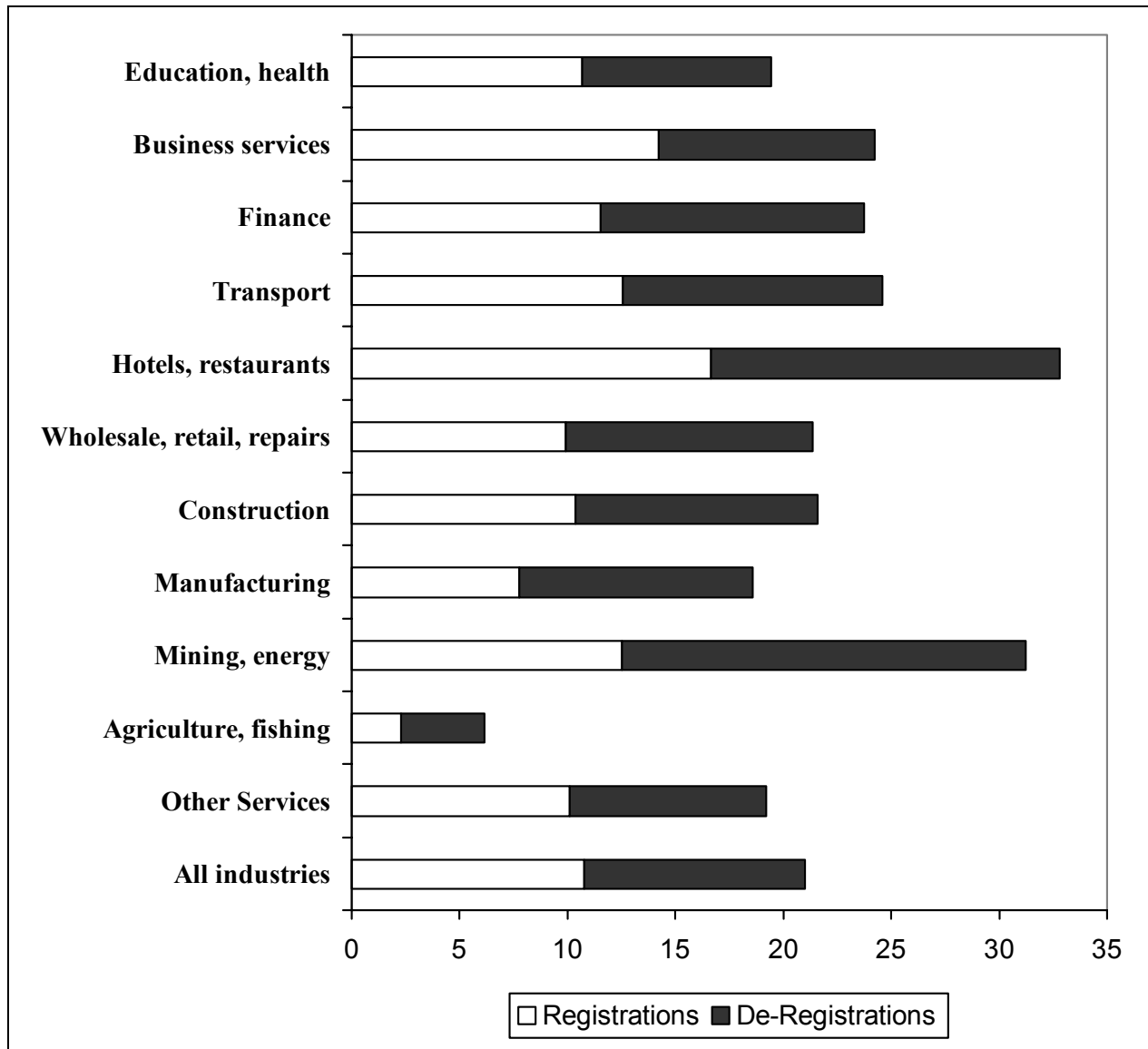
Note: Regions are defined as Government Office Regions

Registration and De-Registration Rates per 10,000 Resident Adults by Country and Region, 1999.



Source: Small Business Service (Research Unit), 2000.

Registrations and De-Registrations as % of Stock, 1999



Source: Small Business Service (Research Unit), 2000.

Self-Employment Business Start-ups

Many start-up companies begin either as a one-person operation or are driven forward by the founder. Some methods for educating and training prospective business-people:

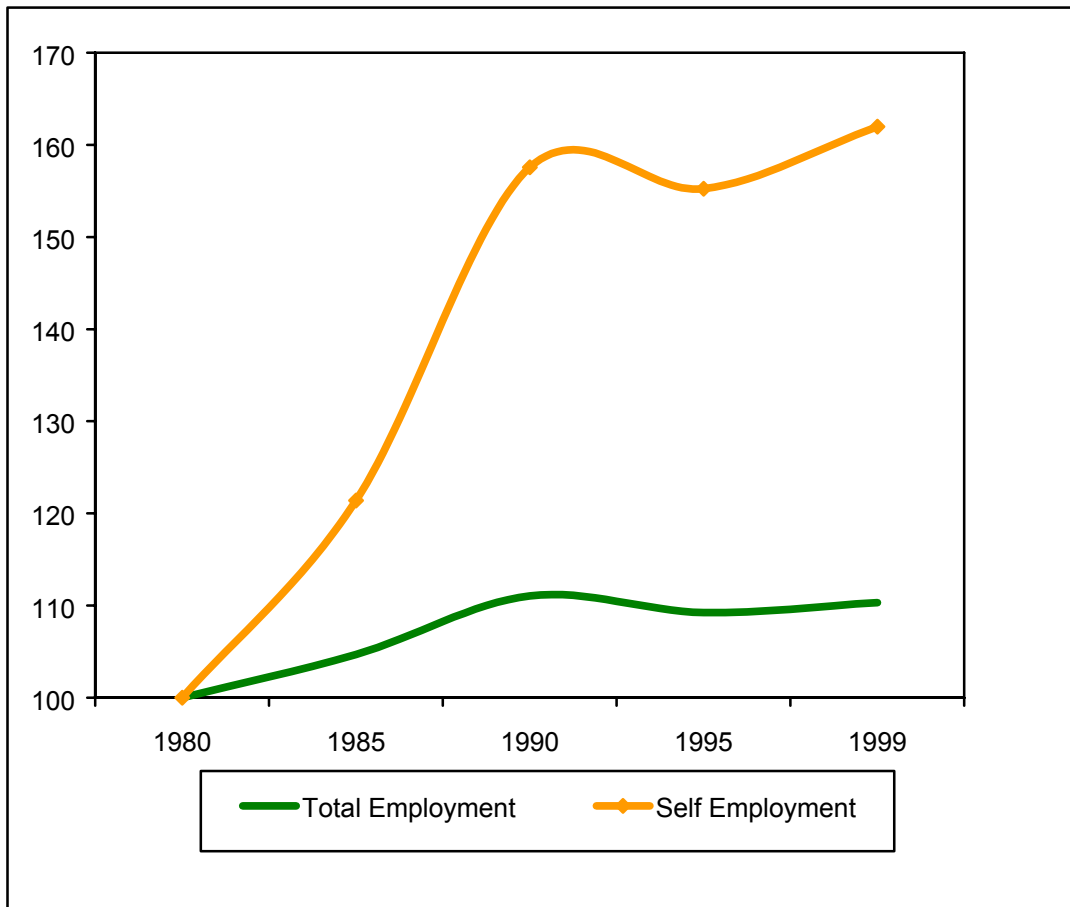
- learning on-the-job through experience;
- supplementing experience with management training;
- undertaking advanced management education (such as the MBA).

(Scott, Rosa and Klandt, 1998).

Self employment and employment

- Self-employment increased significantly in the UK from the 1960s until the present.
- The greatest period of growth occurred during the 1980s.
- While total employment grew by just over 10%, self-employment grew by 63%. Hence the share of self-employment in total employment grew from 8% to 12%.
- Self-employment has been a driver of employment growth.
- Total employment increased by 2.7m over the period - almost 50% of this was accounted for by the increase in self-employed people.

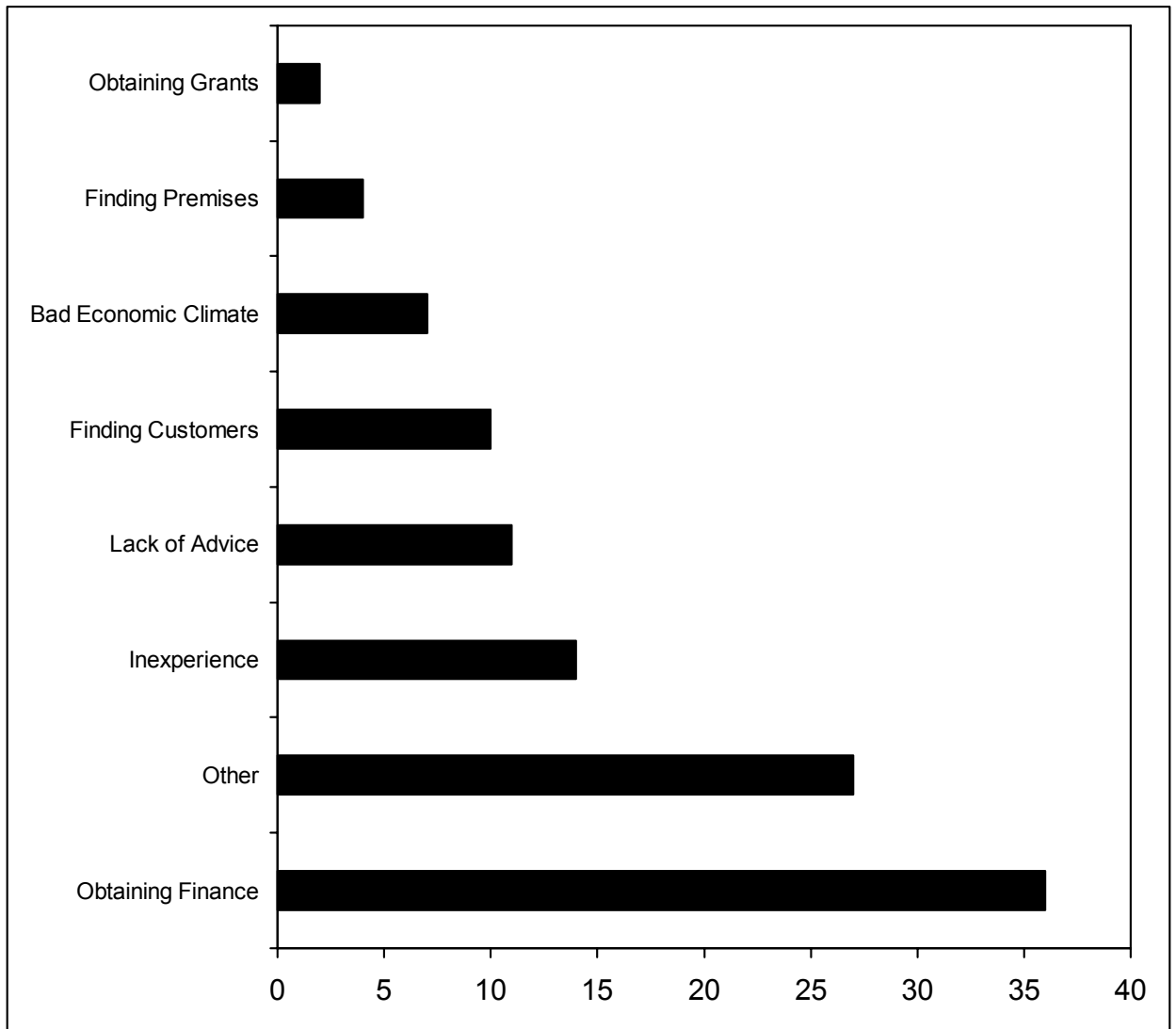
Changes in Total and Self-Employment, 1980-1999 (1980 = 100)



Source: Labour Force Survey

REASONS FOR SUCCESS AND FAILURE

Main Problems Entrepreneurs Face in Getting Started (%)



Source: Scottish Enterprise, 1992

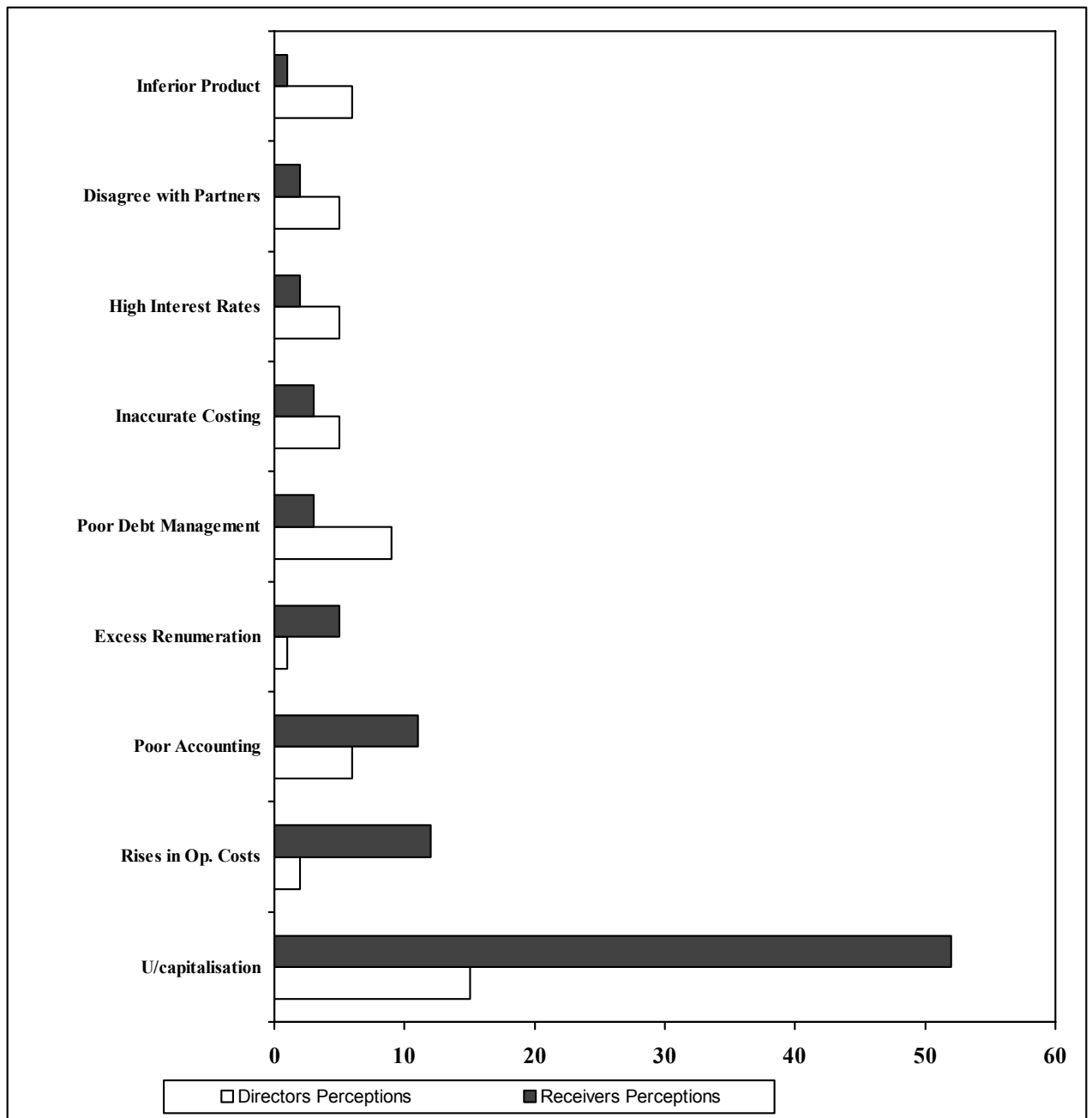
Cambridge Policy Consultants (1998) identifies 5 principal barriers to business start-up and survival:

- access to finance;
- business 'know-how' / access to technical support;
- access to premises and facilities;
- confidence and support network issues;
- lack of economic rationale.

Factors in Failure

- In the UK, 30% of new firms cease trading by the third year and 50% by the fifth (DTI, 1997).
- Most empirical studies have consistently shown that small firms have higher failure rates than larger firms (Storey, 1994).
- In addition, only a very small proportion grow to employ 50 or more workers.

Reasons for Small Business Failure (%)



Source: Hall and Young, 1991.

Factors in Success

Around 50% of the employment gains attributed to start up and small firm growth come from only 4% of the stock of start up companies after ten years.

In Massachusetts, only 2.8% of all companies starting in 1978 employed more than 50 people by 1990.

Storey (1994) provides a series of factors which appear common to start-up companies able to achieve growth.

- Successful companies demonstrate an ability to shift into (usually marginal) different product markets.
- Most growing companies recruit experienced management from outside.
- Marketing expertise is critical for new companies with new products.
- Human resource management policies should link different parts of the small firm together, and encourage team working practices and flexible management systems.
- Businesses which survive and grow reinvested heavily in the company and take out few profits for personal consumption.
- Successful companies must have good, long-term relationships with banks. This is helped by good financial management to track performance.

- He recommends a shift away from overdrafts to longer term loans and equity investments by banks to allow more company stability. Owners of companies must also be more willing to invite outside investment from this and other sources.
- Those companies which are successful tend to seek quality private sector advice from solicitors, accountants and management consultants.

Barriers to Growth

Storey (1994) reports a survey carried out by the Cambridge Small Business Research Centre (SBRC) of 1,993 businesses. Respondents were asked to rank eleven possible constraints on growth. For all firms, the two most important issues were financial.

Constraints on Ability to Meet Business Objectives

Constraint	Rank
Availability and cost of finance for expansion	1
Availability and cost of overdraft facilities	2
Overall growth of market demand	3
Increasing competition	4
Marketing and sales skills	5
Management skills	6
Availability of skilled labour	7
Acquisition of new technology	8
Difficulties in implementing new technology	9
Availability of appropriate premises or site	10
Access to overseas markets	11

Source: Storey (1994).

Stable or declining firms ranked 'overall growth in market demand', 'availability and cost of overdraft facilities' and 'increased competition' as key constraints.

Fast growth firms ranked 'availability and cost of finance for expansion', and 'marketing and sales skills' as the main problems they have to surmount to expand.

Financial issues are important to all firms, but they are especially important for growth firms as are issues related to employee skills.

A survey by Barkham *et al* (1996) of firms found a variation between growth and static or declining firms. Growth firms emphasised:

- lack of management time to develop new products and markets
- poor labour quality
- bad debts/late payment
- management difficulties
- lack of suitable finance

Static or declining firms, on the other hand, emphasised market and labour force issues:

- lack of demand
- heavy competition
- shortage of labour
- poor quality of labour

- bad debts/late payment
- lack of management time to develop new products and markets

Gibb (1993), in a summary of research into one hundred growth companies, found that there are many different routes to growth. Five main types of firms were identified:

- **'Rapid Growth'** to a turnover of several hundred thousand pounds a year within three years of start up.
- **'Spectacular Growth'** from start up to a turnover exceeding £10 to £15 million per annum within seven years.
- **'Second Stage Growth'** after consolidation at a turnover of around £1 million for the first three to five years, to a turnover growth of several million pounds following this.
- **'Second Stage Very Fast Growth'** after a consolidation period at a turnover of around £1 million after three to five years following start up, to a rapid turnover growth to £10 - £20 million in the next three to five years.
- **'Growth of Mature Companies'** i.e. those over 20 years old, who increase turnover by several hundred per cent in the space of five years after earlier years of little or no growth.

The ***mechanisms*** which led to growth in a survey of the same 100 growth companies further complicate the picture.

The surveyed companies grew by:

- dependency on a single or limited set of customers as a subcontractor;
- acting as a consultant leading on to product design and development;
- producing a single product in an expanding market;
- product and/or market diversification;
- means of a full or partial programme of acquisition and/or merger;
- failure and reconstruction;
- starting off as a team with a firm ambition to grow;
- gradual transition from local to national to international markets;
- tackling national and international markets from birth;
- a process of franchising and licensing.
- I.e. no one method.

(Gibb, 1993)

Summary

SMEs have grown in numbers and in their importance to the UK economy significantly in recent decades.

Growth is largely related to the increased flexibility of the economy.

Consumer demand has fragmented markets and increased the number of market niches for small business to fill.

Technology has lowered market entry costs, reduced the advantages of bigger units associated with economics of scale, and made small firms more competitive due to their flexibility.

Entrepreneurship

There are a number of meanings of the term **entrepreneur** (see McQuaid, 2002, for a discussion of this). As discussed previously in this series of lectures, It may be used to mean the event of starting-up a business venture (Gartner, 1988). The entrepreneur usually assumes personal and business risks associated with the new business and continue to actively manage its operation. It is also often used to refer to those who own and manage small businesses.

Entrepreneur Backgrounds

Type 1: An experienced employee working in an established company who cannot advance any further on the career ladder in their current place of employment. Setting up their own business allows them to advance both in career and income terms.

Type 2: An experienced worker in an existing company forced into setting up their own business as a result of employment insecurity caused principally by their age.

Type 3: A younger and well educated person. Motivations for starting businesses were more complex than in the other two cases. Major factors were a desire for independence, a means of achieving self fulfilment and an intense interest in a trade.

Profile of an Entrepreneur

Characteristic	Traits
Self confidence	Belief in ability, independence, optimism
Strong will power	Persistence and perseverance, determination
Task / result oriented	Achievement-oriented, hard work, initiative
Risk-taker	Risk assessment and judicious risk taking ability
Leadership	Good communicator, responsive to suggestions, develops other people
Originality	Innovative, creative, flexible. resourceful, versatile, knowledgeable
Future-oriented	Foresight, vision, perceptiveness

Source: International Labour Organisation, 1998.

In terms of business abilities, CEDEFOP (1991) listed:

- management ability, particularly in commerce and law;
- an ability to think conceptually, i.e. to link ideas to practice and simplify complex problems;
- an ability to convince and communicate ideas and instructions;
- people management skills, particularly the ability to recruit a good staff team and to motivate staff through delegation especially through a team management structure.

An OECD (1998, 2003) study described the 'three pillars of entrepreneurship' as:

- conducive framework conditions (the institutional arrangements within which economic activity takes place must be supportive of entrepreneurship) ;
- well-designed government support programmes; and
- supportive cultural attitudes.

Further factors relating to the company which contribute to entrepreneurial activity were:

- an international sales perspective;
- technically well developed products;
- good relations with financing institutions over the long term;
- close relationships with public sector economic development agencies.

There are other meanings of Entrepreneurship

Entrepreneurship as a function in the economy

- Risk
- Co-ordination, allocation and use of resources
- 'Middleman'
- Innovation - products, methods of production, new markets;
new sources inputs; or by changing the structure of an
organisation or an industry.

Entrepreneurship as a set of personal characteristics

Samuel Smiles (1859): the key psychological traits of an entrepreneur were integrity, self-learning, courage, conscientiousness, patience, perseverance, self-discipline and self-respect.

More modern:

Particular qualities or attitude (see for instance: ROBINSON *et al.*, 1991);

motivations (Kuratko *et al.*, 1997);

their being a 'great leader' (Hughes, 1986);

or social forces (Reynolds, 1991).

'Everyman'.

Entrepreneurship as a form of behaviour

what entrepreneurs do, rather than who they are

Peter Drucker (1985) an entrepreneur is a person who “always searches for change, responds to it, and exploits it as an opportunity.”

entrepreneurship “consists in the purposeful and organised search for changes, and in the systematic analysis of the opportunities such changes might offer for economic or social innovation”

Stevenson and Sahlman (1989), “entrepreneurship is most fruitfully defined as the relentless pursuit of opportunity without regard to resources currently controlled”.

POLICIES

Macro-level policies to promote entrepreneurship

Micro-level policies to promote entrepreneurship

advice and training;

finance;

technology;

markets;

physical infrastructure;

and influencing the characteristics of the locality.

Entrepreneurial culture

(see McQuaid, 2002).

Some useful websites

Business Links: www.businesslink.co.uk

Department of Trade and Industry: www.dti.gov.uk

US Small Business Administration: www.sba.gov

Scottish Enterprise Small Business Gateway:

www.sbgateway.com

Department of Enterprise, Trade and Investment –
Statistics Research Branch:

<http://www.nics.gov.uk/deti/statsres/>

Napier University:

<http://www.napier.ac.uk/depts/eri/home.htm>

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