UNLOCKING UK PRODUCTIVITY

Internationalisation and Innovation in SMEs
Unlocking UK Productivity – Internationalisation and Innovation in SMEs

We would like to celebrate the 10,000 Small Businesses UK Graduates.

Please note, these are the names of all the businesses that have graduated the programme and include businesses that have since been sold, merged or acquired by other entities.
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Foreword: Goldman Sachs

Michael Sherwood and Richard Gnodde are co-CEOs of Goldman Sachs International

In 2010 we made a commitment to support the UK economy by providing business education to small businesses and social enterprises through 10,000 Small Businesses.

Over the past five years, the programme has seen almost 1,000 businesses participate in high-quality practically-focused business and management education delivered through our university partners across four regions in the UK.

Today, we are proud to be extending our commitment.

This recommitment comes at a time when further engagements are necessary to support the UK government’s agenda in boosting productivity.

In the July 2015 ‘Productivity Plan’, the UK government identified productivity as the ‘challenge of our time’ and set out an ambition to deliver ‘world-beating productivity’ in driving the next phase of economic growth, a key opportunity for the UK.

We believe the education of high-growth small businesses has a vital role to play in enhancing this enterprising economy.

With this report, we are proud to announce our partnership with the British Business Bank and the Enterprise Research Centre – with support from the Scale-Up Institute and Said Business School, Oxford University. Together we hope to use our evidence and findings to help the UK government support high-growth firms – strengthening the UK’s entrepreneurial ecosystem and boosting productivity.

We look forward to working with businesses around the UK and creating the most innovative and relevant learning opportunities. The entrepreneurial community we have created is truly inspirational and we welcome the chance to collaborate with others in supporting the UK’s growth agenda.
Foreword: 
British Business Bank

Ron Emerson is Chairman of the British Business Bank

When the British Business Bank was invited by Goldman Sachs to work with them and the Enterprise Research Centre on this report, we were delighted to contribute to the project.

It is important to consider how improvements to the wider SME support environment and the SME sector in general might be achieved, and this report provides valuable insight into how upgrading innovation, internationalisation and productivity might help build our economy. Much of what is needed, of course, requires improvements in access to finance as an enabler.

This is where the British Business Bank, one year after its formal creation, is beginning to play a major role as it delivers on its objectives agreed with the government – increasing the supply of finance in areas where finance markets do not work effectively, helping create greater choice for businesses in terms of providers and financial products, and providing better information in the market to build confidence among smaller businesses in the finance options available.

Our work in improving finance markets is helping to secure wider government objectives around investment and growth in the economy, and it is now widely recognised just how important smaller businesses are to growth. Addressing the challenges and obstacles they face in accessing the finance they need to start, grow and thrive is at the core of what we do. We work through the market, providing finance and offering guarantees in partnership with over 80 commercial lenders and investors. These partners use our backing – together with their own money – to lend to or invest in smaller UK businesses. In this way we leverage our impact in the market by drawing in private sector capital to our areas of focus – whether it be playing a major role in the provision of early-stage equity funding, enabling growth capital provision, or facilitating senior debt for more established businesses.

We are also raising awareness of finance options through our highly-regarded Business Finance Guide, jointly published with the ICAEW and with contributions and endorsement from organisations across the financial and business sectors. Convening such a wide group for the good of smaller UK businesses is a good illustration of what we can achieve through our unique place in the SME finance ecosystem.

As a champion for smaller businesses in the UK, we recognise and welcome the significant financial investment and resource commitment that Goldman Sachs has made to businesses so far through their 10,000 Small Businesses programme. This kind of initiative is clearly making a real difference to those businesses, and we wish its participants every success.

From our experience, partnership between private and public sector – each bringing its own strengths to bear – can be the optimum solution for smaller business support in the UK, capable of delivering the best outcomes for smaller businesses, the public purse and for the UK economy more widely in terms of growth and jobs.

I hope this report proves valuable in furthering the debate around how best to improve our smaller businesses’ capability in innovation, internationalisation and productivity, and that you find it interesting and informative.
Executive Summary

The UK faces a productivity challenge whereby its performance has weakened compared to the rest of the G8 economies. Research demonstrates that small and medium-sized enterprises (SMEs) are a key under-tapped resource for addressing this challenge – especially when engaged in international and innovative activities.

This report seeks to identify and encourage the ways in which internationalisation and innovation can act as key drivers for growth among SMEs – in turn boosting UK productivity. The report makes the following arguments:

› **The UK has an opportunity to enhance its productivity**: Whilst before 2008 productivity in the UK was on a strong upward trend, the UK’s productivity performance has since weakened compared to its international counterparts. Improving this has become a vital agenda for the UK government.

› **SMEs have a key role to play in addressing this challenge**: The SME contribution to the UK economy is significant – accounting for 60% of all private sector jobs and 47% of revenue. Boosting SME productivity growth can have a significant impact on UK productivity growth at large.

› **The role of internationalisation and innovation in boosting SME productivity growth has been relatively underexplored, despite strong evidence of its positive impact**: Whilst much attention has focused on structural factors such as access to capital, leadership and entrepreneurial capabilities and having the right talent, evidence strongly indicates that those businesses that engage in international activity and innovation are more likely to enhance firm performance – including productivity growth.

- It is estimated that between 9 and 12% of non-exporting firms within the UK could become exporters and just over half that do export could become persistent exporters. Together these two groups include more than 110,000 SMEs in the UK economy. If they are successfully encouraged to export or export persistently, an additional £1.15 billion Gross Value Added (GVA) could be added to the UK economy within the first year.

- Internationally active SMEs are three times more likely to introduce products or services that are new to their sector than those which are entirely domestic in orientation.

- Despite this positive relationship, however, only 1 in 5 SMEs are exporters.

› **The limited engagement by SMEs in internationalisation and innovation can be explained, in part, by SMEs’ low growth ambition**: UK SMEs are demonstrated to be less ‘growth-
“Productivity is the challenge of our time. It is what makes nations stronger, and families richer. Growth comes either from more employment, or higher productivity. We have been exceptionally successful in recent times in growing employment. We are proud of that. But now in the work we do across government we need to focus on world-beating productivity, to drive the next phase of our growth!”

Rt. Hon George Osborne and Rt. Hon Sajid Javid

inclined’ and ambitious than other G8 economies. The Global Entrepreneurship Monitor alone has pointed to a 17% growth aspiration in the UK among entrepreneurs vs 27% in the US.

In this context, the following recommendations are considered:

1. **The overall entrepreneurial ecosystem needs to be nurtured to encourage greater growth ambition among SMEs.**

2. **We need to expand and increase appropriate forms of education to help build the UK’s entrepreneurial ecosystem:** Practical and impactful business education for SMEs is fundamental in providing SMEs with the appetite to internationalise and innovate.

3. **Capital is a critical enabler for SMEs to internationalise and innovate:** Solutions focus on initiatives that stimulate demand and support supply through debt and equity financing.

The UK’s Productivity Challenge

Enhancing the UK’s Productivity Potential

**WHAT DO WE MEAN BY PRODUCTIVITY?**

Productivity is the efficiency in operating a business: that is, how much output is obtained from a given set of inputs. The business owner is interested to know how productive its assets are to generate profit. Commonly used indicators such as sales to assets, return on assets, inventory turnover, and receivable turnover are often subject to market price and cyclical fluctuations and, therefore, tricky to assess and compare. For that reason, economists use the term productivity to measure how effectively businesses use labour and capital to generate products and services.

The UK has an opportunity to enhance its productivity. UK productivity levels are currently lower than other major European economies – such as Germany and France – and significantly behind the US. Fig 1

Before the ‘Great Recession’, productivity in the UK was on a strong upward trend. However, since 2008, the UK’s productivity performance has weakened compared to the rest of the G8 economies, although recently shows increased signs of revival.
Measuring productivity as GDP per hour worked, the UK’s productivity performance has been static in the period since 2008. Fig 2 The UK-G8 productivity gap in 2013 was 6%.

The Bank of England reported the UK’s weak labour productivity in more absolute terms: in 2013 productivity levels were at 14% below the pre-crisis trend level. This has since worsened with 2015 estimates suggesting a drop to 16% below pre-crisis levels. Since the recent recession, productivity change in the UK has been marked by an extraordinarily flat trend over a long period of time.

Since 2008, the UK’s productivity performance has weakened compared to the rest of the G8 economies, although recently shows increased signs of revival.

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SMEs are Finally Getting More Credit

Kevin Daly is a Senior European Economist in Goldman Sachs Global Investment Research

It is now eight years since the global financial crisis began. In those eight years, the UK experienced five years of chronic underperformance, followed by three years in which it has been the strongest performing major economy in the world.

In the first period – from late 2007 to late 2012 – four features of the UK economy’s performance were unusual (and unusually bad): First, the 2008/09 recession was exceptionally deep and the recovery from that recession exceptionally weak, both relative to past UK recessions and relative to other major economies. Second, the performance of labour productivity was particularly poor. Third, the sharp fall in Sterling’s trade-weighted exchange rate in 2008/09 provided little benefit to the UK’s trade balance. And, fourth, despite the weakness of the real economy, inflation remained stubbornly high – annual headline and core inflation averaged 3.3% and 2.5%, respectively, in the five years to 2013Q1.

In the second period – from early 2013 until today – these four failings have been reversed: UK economic growth rose sharply in the first half of 2013 and has averaged 2.7% per year since then, surpassing both the US and the Euro area. Productivity growth has been slower to recover, but it has also shown signs of revival this year. The UK’s trade balance (for goods and services) has fallen from 2% of GDP in 2012 to around 1% of GDP this year, despite Sterling reversing much of its previous weakness over this period. Headline inflation has averaged just 0.9% on an annualised basis, while core inflation has averaged 1.3%.

What accounted for the UK’s transformation from serial underperformer to consistent outperformer? In our view, one of the key drivers was a turnaround in the availability of credit that began in the second half of 2012 and supported growth in investment and consumer expenditure. Where a lack of credit availability in the aftermath of the financial crisis had held back growth and prevented a necessary re-allocation of capital and resources across the economy, the subsequent easing in the availability of credit boosted growth and facilitated that re-allocation.
This easing in credit availability was the result of two developments that took place in mid-2012: First, the Bank of England launched the Funding for Lending Scheme (FLS), signalling a shift in strategy from Quantitative Easing to Credit Easing; and, second, there was a significant reduction in the perceived risk of a Euro area break-up following ECB President Mario Draghi’s famous “whatever it takes” commitment.

Both developments contributed to a sharp reduction in the funding costs of UK banks, enabling them to start lending again. Within six months of these initiatives being taken, there was a tangible loosening of credit conditions. Each of the major UK banks launched nationwide advertising campaigns at the start of 2013. Less conspicuously, the cost of new lending began to ease and the amount of outstanding lending began, slowly, to recover.

However, while there was a significant easing in credit availability from late-2012 onwards across the economy as a whole, some sectors of the economy initially benefited much more than others. In particular, while households and large corporates witnessed a significant easing, small and medium-sized enterprises (SMEs) were much slower to benefit.

This is clear from developments in the cost of lending: the average interest rate on new loans to households and large corporates fell significantly from late-2012 onwards but remained stubbornly high for SME loans.

It is also clear from the Bank of England’s Credit Conditions Survey and from surveys of credit availability in which the questions are posed to households and corporates rather than to the banks: while households and large corporates have been indicating a significant easing in credit availability for some time, SMEs have – at least until recently – reported that the availability of credit remains ‘poor’ or ‘very poor’.

Given the critical role that small, start-up companies play in driving productivity growth in particular, the continued lack of availability of credit to SMEs could help to explain why the problem of weak productivity growth has been the slowest of the UK’s four post-crisis ‘failings’ to be reversed.

The good news is that there are now encouraging signs that credit availability to SMEs is also beginning to ease. According to the SME Finance Monitor, the rejection rate on SME loan applications has fallen from more than 40% in the first half of last year to close to 25% in the latest data.

In surveys, SMEs have begun to report that credit availability is ‘normal’ rather than ‘poor’ or ‘very poor’. And, very slowly, the cost of bank lending for SMEs has also started to fall.

It is critical for the UK’s prospects to have a thriving SME sector. Small and medium-sized firms account for around half of national output and close to 60% of employment. Moreover, the successful SMEs of today will develop into the large firms of tomorrow.

The growth of the UK’s SME sector has been curtailed since the financial crisis by a lack of credit. The easing in the availability of credit to SMEs that now appears to be underway is good news for the sector and good news for the UK.
How do SMEs Improve Productivity?

The Link Between SMEs and Productivity Growth

SMEs have the potential to contribute to UK economic growth as follows: stimulating innovation, spurring competition and accelerating job creation. Fig 3

Growth rates among SMEs that innovate are significantly greater than those that do not – many studies show a positive relationship between innovation and higher growth rates and there is some evidence of a positive relationship between both product and process innovation and productivity growth.

Innovative SMEs are also more likely to be operating in export markets and as a result lead to economy-wide productivity benefits through dynamic competition in which innovating and exporting firms gain market share at the expense of others.

DEFINITIONS OF SMALL AND MEDIUM-SIZED BUSINESSES

SMEs are defined as all businesses with between 0 and 249 employees.

A High Growth Firm (HGF), according to the OECD, is a firm with at least 10 employees at the beginning of the period and which records an annual average growth of 20% in employment over a three year period.
Evidence also shows SMEs contributing a disproportionately large amount to UK job creation. Between 2008 and 2013 a high proportion (85%) of new jobs in the UK were created by firms with fewer than 50 employees\(^8\).

The SME population in the UK has grown by 14% since 2011. Their contribution to the UK economy is significant: SMEs in the UK now account for 15.6 million (60%) of all private sector jobs in the UK and £1.75 trillion (47%) of revenue per annum.

SMEs, therefore, make up the majority of private sector employment and almost half of private sector turnover. *Fig 4*

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**SMEs have the potential to contribute to UK economic growth as follows:** stimulating innovation, spurring competition and accelerating job creation.

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*Fig 4*

<table>
<thead>
<tr>
<th>Number of SMEs</th>
<th>Year 2015</th>
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<tr>
<td>MICRO BUSINESSES, 0–9 EMPLOYEES, £673 BN TURNOVER</td>
<td>5,147,000</td>
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<tr>
<td>SMALL BUSINESSES, 10–49 EMPLOYEES, £543 BN TURNOVER</td>
<td>204,000</td>
</tr>
<tr>
<td>MEDIUM BUSINESSES, 50–249 EMPLOYEES, £538 BN TURNOVER</td>
<td>33,000</td>
</tr>
<tr>
<td>LARGE BUSINESSES, 250+ EMPLOYEES, £1,956 BN TURNOVER</td>
<td>7,000</td>
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Source: BIS, Business Population Estimates 2015 (Numbers rounded to the nearest 100)

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Some SMEs Are Already Boosting Productivity

High-growth SMEs (some 10,000 businesses) represent less than 1% of established businesses in the UK, yet those in existence for more than 3 years generate 20% of all job growth. These businesses are operating in all sectors of the economy and there is no spatial concentration as they are found in all regions and nations of the UK.

Other evidence about these High-Growth Firms shows that they demonstrate above average levels of productivity growth, high levels of innovation, strong levels of export-orientation and a high level of internationalisation. However, the relatively low number of high-growth firms in the UK suggests that there is further potential to increase productivity.

SMEs Can Play a Greater Role in Boosting UK Productivity

Despite the considerable contributions SMEs can make to UK productivity growth, most UK SMEs are currently not boosting productivity. Only a small number of high-growth SMEs out of the 5.4 million private sector SMEs in the UK are responsible for job creation and productivity growth.

Instead, the UK’s established SME population has fewer growth firms and a greater number of firms contracting compared to other advanced economies. So, although the UK has record levels of start-ups in recent years, many of these are ‘zero’ employee and micro-enterprise firms (i.e. fewer than 10 employees) with no real desire to grow. For many of these ‘new’ entrepreneurs, independence, both from a financial and a personal perspective, can be the main motivation for starting a new business. Nevertheless, they remain a vital component of local economies across the UK.

Further, around 90% of SMEs have fewer than five employees and only 20–30% will survive for a decade. Of those firms which survive to age 10, around 75% are born with fewer than five employees will still have fewer than five employees.

Recent evidence from the OECD also shows that the UK has one of the lowest proportions of micro-enterprise start-ups (i.e. fewer than 10 employees) that grow to more than 10 employees in three years. Combined with a higher proportion of ‘no growth’ firms in the UK compared to other advanced economies, this can be seen as a major factor contributing to low productivity. Fig 5
Therefore, there is significant potential in the UK SME business population for growth and in particular productivity growth\(^9\).

There are, however, structural factors in the UK preventing the more growth-oriented SMEs from increasing their productivity.

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Only a small number of high-growth SMEs out of the 5.4 million private sector SMEs in the UK are responsible for job creation and productivity growth.

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\(^9\) Using the OECD definition a High-Growth Firm (HGF) is a firm with at least 10 employees at the beginning of the period and which records an annual average growth of 20% in employment over a three year period.


\(^11\) Octopus Investments (2015) “High Growth Small Business: How Britain’s fastest growing smaller companies can be a force for regional revival”.


\(^19\) There is another small group of the overall business population (~4% or around 50,000 businesses) who have contributed a considerable amount to UK productivity growth in the 1998–2013 period. This group is described as ‘Growth Heroes’ as they show impressive employment growth but even faster turnover growth leading to an overall increase in their average labour productivity. They also showed resilience during the ‘Great Recession’ and make a disproportionate contribution to current aggregate labour productivity (~20%). These ‘Growth Heroes’ tend to be SMEs and to operate in the professional services and manufacturing sectors. ERC are currently undertaking further research on these ‘Growth Heroes’.

\(^20\) Coutu, S. (2014) op. cit.

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The ‘Scale-Up Report’ in 2014\(^20\) identified a number of barriers growth-oriented businesses face when scaling-up and addressing low productivity. Four key structural factors are seen as limiting SME growth:

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**PROPORTION OF MICRO BUSINESSES THAT GROW TO 10+ EMPLOYMENT WITHIN THREE YEARS, AND START-UPS AS PROPORTION OF ALL FIRMS**

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**Fig 5**
Many SMEs do not have an active growth agenda but still contribute a great deal to UK economy and society.

Difficulties in supporting the leadership capabilities of SMEs has been identified as a key barrier to growth\(^2\). For example, many SME founders face challenges when expanding their leadership team. The evidence indicates that this challenge can have a negative effect on turnover, productivity and employment growth.

People talent and skills have also been highlighted as a key barrier to productivity growth. There are concerns that SMEs are unable to easily find and acquire the necessary talent and skills to drive growth. Currently, access to a European labour market presents a key opportunity for finding and acquiring these skills through labour market mobility.

Access to capital is often required to fund SME expansion. The use of external finance is associated with higher growth rates and the challenge is to encourage more small business owners to seek external debt and equity finance from the growing range of available sources.

Internationalisation and innovation have a major role to play in contributing to SME productivity growth. Evidence indicates that those businesses who engage in international activity (either by exporting or through undergoing business activity outside the UK) are more likely to be innovative and together this enhances firm performance including productivity growth\(^2\).

While there has been a great deal of focus on access to capital in recent years as well as the wider skills agenda there is considerable scope to explore in more detail the role of internationalisation and innovation in contributing to SME productivity growth. Together, they have the potential to deliver short-term gains in terms of improving overall UK productivity.
Access to Capital and the British Business Bank

Structural failures in the market for SME finance have long been acknowledged dating back to the MacMillan report of 1931 which identified a long term funding gap. This was exacerbated during the recession, with the data suggesting a significant decline in both debt and equity finance flows to SMEs, accompanied by corresponding increase in rejection of loan/overdraft applications.\(^2^3\)

The latest evidence in the UK suggests SME finance markets are recovering to some extent. The past year has seen an easing in the availability of credit with net SME lending edging positive in the last three quarters\(^2^4\) and flows of equity finance to SMEs also recovering over recent years\(^2^5\). Fewer SMEs report a lack of access to finance as a major constraint on expansion.\(^2^6\)

However, rejection rates for loans are still material, particularly for smaller SMEs and first time applicants.\(^2^7\) Those SMEs that do use finance are increasingly doing so to purchase fixed assets and fund expansion, with less seeking finance for working capital or cash-flow purposes.\(^2^8\)

With nearly 60% of SMEs expecting to grow in the coming year, access to capital will be an important enabler for those with growth ambitions.

The British Business Bank has been established to deliver both a greater volume and choice of finance to SMEs. Reflecting the different structural market problems in SME finance, the BBB has specifically designed products for three market segments:

- **Start-Ups** – SMEs that are less than 2 years old.
- **Scale-Up** – SMEs looking to expand rapidly, having achieved positive growth over the last 12 months.
- **Stay ahead** – viable SMEs seeking a loan to grow, or simply in need of day-to-day finance.

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26 In a survey among 10KSB participants, access to capital ranked 4th in importance out of 5 challenges.
27 BDRC Continental “SME Finance Monitor Q2 2015”.
29 Federation of Small Businesses (2015), Small Business Index.
Internationalisation and Innovation

Introduction

The previous section highlighted four main structural factors which can impact upon the ability of SMEs to grow. The focus here is on one of those structural factors – internationalisation and innovation. This combination is a useful prism for understanding how SMEs who want to grow can achieve their ambitions and make a significant contribution to UK productivity growth. They underline the importance of the global market place and the process of innovation in shaping the future growth trajectory of the UK economy.

Internationalisation and Productivity Growth

Benefits of Thinking Globally

SMEs that engage in internationalisation activity drive productivity growth in four main ways:

- **Stronger competition** in non-domestic markets forces firms to improve both products and processes and remain competitive;

- Exporting SMEs have noted cases of ‘learning by exporting’. Firms have had significant exposure to foreign knowledge and technology, which has helped to boost their productivity;

- Exporting has **extended the geographical market** over which margins can be earned. As many costs are largely fixed, such investments may be recouped over a larger sales volume.

- Exporting has also led to greater diversity in the customer base, which has helped to stabilise revenue.

In addition, a recent UKTI survey found that 85% of UKTI clients felt exporting led them to achieve growth that would not otherwise have been possible.20

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**WHAT DO WE MEAN BY INTERNATIONALISATION?**

In general, internationalisation is defined as including such activities as international acquisitions, establishing overseas offices, subsidiaries, joint ventures, sourcing products and supplies from overseas as well as exporting. The term ‘exporting’ we use here in its normal sense of outward international trade in goods and/or services, conducted either directly or through a third party (such as a sales agent). Exporting is often the initial stage in the internationalisation process for SMEs.
UK SMEs and Internationalisation Activity

Despite the positive relationship between internationalisation and productivity, few SMEs have chosen to engage in selling overseas. Recent research\(^\text{31}\) has shown that just over 1 in 5 SMEs are exporters. Of these, only 17% can be classified as ‘persistent exporters’\(^\text{32}\) and only 5% as ‘intensive persistent exporters’\(^\text{33}\).

In addition, the 2015 Barclays Export Index\(^\text{34}\) has found that the UK so far has not reached its target to increase the number of UK businesses exporting by 100,000. \(\text{Fig 6}\)

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\(^\text{30}\) UKTI (2013) – Bringing Home the Benefits: How to Expand Through Exporting.


\(^\text{32}\) Persistent exporters are defined as those businesses continuously selling to overseas markets for more than 2 years.

\(^\text{33}\) Intensive Persistent Exporters are a smaller group of businesses defined as mature firms more than 5 years old for which exports account for more than 50% of sales.

\(^\text{34}\) Reform Barclays Export Index (2015) “The UK’s export ambition: building on success”
Furthermore, the UK lags behind France and Germany in terms of the propensity of SMEs to export. The Global Entrepreneurship Monitor (GEM) Global survey in 2014 found that only 16% of UK established businesses have more than 25% of customers outside the country compared to 22% in France and 21% in Germany. *Fig 7*

From the perspective of the SME owner, however, the decision to start exporting, or entering overseas, is not clear cut.

There are a significant number of potentially costly hurdles in terms of both time and money. These include:

- Commissioning market research or committing resources to undertake it in-house;
- Setting up new distribution networks – which can prove time consuming in finding the right partner;
- Identifying and contracting with potential new partners;
- Aligning their range of products and services to international markets;
- Understanding the local market, culture and dynamics, including ‘how to do business’.

In most cases, only those SMEs with large profits or cash reserves will be able to cover these fixed costs of entry. Exporting SMEs are more productive than non-exporters as only the most productive SMEs are able to overcome these costs. The decision to export among SMEs, therefore, appears to be a self-selecting process.

![Bar chart showing exporting more than 25% of customers outside the country](image-url)
Innovation and Productivity Growth

Benefits of Engaging in Innovation

The importance of innovation\(^{37}\) for SME productivity growth is evident in the data. The UK relies on innovation to drive long-term economic growth and improvements in living standards. Innovation at the firm, industry and national level\(^{38}\) accounts for up to 70% of the UK’s long-term economic growth\(^{39}\) and around 51% of labour productivity growth\(^{40}\).

This positive relationship between innovation and SME performance displays itself in three main ways - each one contributing to productivity growth:

- First, there is a positive relationship between innovation and firm performance. In all sectors\(^{41}\), product and process innovation has led to greater productivity, which has allowed for substantial growth in employment and/or sales.

- Second, businesses that innovate are more likely to survive. Since the financial crisis in 2008, those firms who engaged in innovation were better able to adjust when the market conditions became challenging\(^{42}\).

- Likewise, those that innovate were more likely to establish external relationships and, therefore, gain access to external knowledge\(^{43}\). As a result, smaller firms were shown to take greater advantage of these external relationships and innovations than their larger counterparts\(^{44}\).

WHAT DO WE MEAN BY INNOVATION?

Innovation here is defined in its broadest sense and relates to the introduction of new products and services, upgrades to business processes and also to changes in strategy, management approaches or marketing.

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35 ‘Total early-stage Entrepreneurial Activity (TEA)’ includes individuals in the process of starting a venture and those running a new business less than 3 years old.

36 ‘Established Business Owner-Managers (EBO)’ have owned or managed a business for more than 42 months.

37 Innovation here is defined in its broadest sense and relates to the introduction of new products and services, upgrades to business processes and also to changes in strategy, management approaches or marketing.


40 NESTA (2012), Innovation Index 2012.


UK SMEs and Innovation Activity

Compared with other countries in Europe, the evidence suggests that UK SMEs are lagging behind in terms of innovation\(^45\). Using the latest European Union Innovation Scoreboard (2015)\(^46\) data, about 30% of EU SMEs have innovated by introducing a new or significantly improved product or process. In Luxembourg, Germany, Belgium, Netherlands and Finland more than 40% of SMEs have introduced a product or process innovation, whereas the UK is just below the EU average at 28% (ranked 24th out of 34 countries). \(\text{Fig 8}\)

UK SMEs did a little better when innovating in their marketing or organisational efforts: ranking 14th out of 34 countries. About 36% of EU SMEs have innovated by introducing a marketing or organisational innovation compared to 38% of SMEs in the UK.
The Interdependence of Internationalisation and Innovation

The evidence suggests that both innovation and internationalisation are key drivers for UK productivity growth. Innovation or internationalisation alone, however, cannot address the UK’s productivity problem. Research has suggested that the strongest boost to productivity growth occurs when exporting and innovation are undertaken together as part of a coherent strategy.

Positive relationships between the exposure to non-domestic markets and innovation/Research & Development (R&D) are apparent across a majority of countries: exporters can benefit from increased competition, from learning-by-exporting, and from scale effects. Combined, these activities are shown to enhance R&D and innovation, and contribute to productivity.

Firms undertaking R&D and engaged in innovative activities are also more likely to export and to have a greater proportion of revenues driven by exporting.

Research has suggested that the strongest boost to productivity growth occurs when exporting and innovation are undertaken together as part of a coherent strategy.

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Both the quantitative and qualitative evidence from the UK suggests that competition, scale and learning-by-exporting links internationalisation to R&D performance:

- SMEs that innovate are around 7% more likely to export than a non-innovator.
- SMEs that export grow more than twice as fast as those that do not.
- Internationally active SMEs are three times more likely to introduce products or services that are new to their sector than those which are entirely domestic in orientation.

Together innovation and exporting create the potential for high internationalisation and maximise the commercial value of innovations. These joint effects of innovation and exporting lead to economy-wide productivity benefits as the firms involved gain market share at the expense of less productive firms.

Evidence has suggested that we can increase the number of businesses that export. The UK Small Business Survey in 2012 has identified a group of ‘potential exporters’ who possess the characteristics of typical exporters (including intermittent and persistent exporters) but who were not currently exporting. It was estimated that between 9% and 12% of non-exporting firms could become exporters and that just over half the intermittent exporters have the potential to become persistent exporters.

Together these two groups include more than 110,000 SMEs in the UK. Using the most conservative estimate, if this number of businesses were to start exporting or enhance their exporting efforts, then an additional £1.15 billion GVA could be added to the UK economy within the first year of them exporting.
Promoting Innovation and International Activity among SMEs

SMEs can be encouraged to engage in internationalisation and innovation activity through two ‘enablers’: ‘external’ and ‘internal’.

Illustration of External Enablers

Regulatory Environment

The conventional view held by business representative groups, politicians, and the media is that regulation – or ‘red tape’ – is a burden, cost or constraint on businesses. Small businesses are believed to suffer disproportionately from this burden due to resource constraints. The BIS Small Business Survey (2014), for example, suggested that for all small firms, taxation and regulation remains a significant barrier to growth. The Better Regulation agenda has an important role to play here, avoiding unnecessary burdens on SMEs. Initiatives such as One-In, Two-Out and the Red Tape challenge have reduced the burden on business.

WHAT DO WE MEAN BY INTERNAL AND EXTERNAL ENABLERS?

INTERNAL

Here we refer to factors within the firm which affect the capability and capacity of SMEs to engage in internationalisation and innovation activity. This can include such factors as:

• Owner-manager experience and motivations
• Management skills and experience
• Financial resources
• Board structures including whether it is a family-owned business and use of NEDs
• Vision and culture of the business
• Access to knowledge

EXTERNAL

Here we refer to factors in the wider operating environment of the SMEs which may operate to enable internationalisation and innovation activity. This can include such factors as:

• Regulatory environment
• Business support ecosystem (private and public)
• Availability of skilled staff
• Ease of obtaining finance

52 Enterprise Research Centre (2014) ibid.
53 Enterprise Research Centre (2014) ibid.
54 This is calculated as follows. From the Annual Business Survey (ABS) the difference in GVA per employee is £18,000 (£54,000 for exporters and £36,000 for non-exporters. From previous research we have an estimate of the increase to employment achieved by UK firms who start exporting: 2.8% from a study by Girma, S.; Greenaway, D. and Kneller, R. (2004) “Does Exporting Increase Productivity? A Micro-econometric Analysis of Matched Firms”, Review of International Economics, 12(5), 855-866. So, from this we can calculate that the additional boost to GVA by these 110,000 firms is £1.15bn (i.e. 110,000 × £18,000 × 0.028). This is in line with an earlier estimate of the employment impact of ‘starting to export’ based on US data (Bernard, A.B. and Jensen, J.B. (1999) “Exceptional exporter performance: cause, effect, or both?”, Journal of International Economics 47 (1999) 1-25).
57 Federation of Small Businesses (2011) “The burden of regulation”. Available at: www.fsb.org.uk/frontpage/assets/the%20burden%20of%20regulation%20-%20may%202011.pdf
There is evidence, however, which shows that regulation can be seen as a dynamic force, enabling as well as constraining performance – generating contradictory performance effects\(^59\). As a result, it is important to note that the mere existence of a regulation does not necessarily determine its effects.

Business Growth Service\(^60\) data show that regulation was not seen as a major barrier by a group of business owners pre-disposed to growth. In fact, regulation had been a positive factor in taking action to internationalise and innovate.

**Business Support Ecosystem**

UK Trade and Investment (UKTI) have had the most prominent effect in promoting innovation and internationalisation among SMEs:

› Firstly, it has had a substantial positive impact on the profit and medium-term performance of supported firms, linked to stronger business growth.

› Secondly, public support through the UKTI trade development support has had a positive impact on business R&D and innovation – suggesting long-term positive effects on business competitiveness in both domestic and overseas markets\(^61\).

› Thirdly, public support can have a direct and substantial positive impact on business skills and export know-how, helping to relieve the internal resource constraints experienced by SMEs\(^62\).

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**Growth ambition has proven crucial for SMEs to engage effectively in internationalisation and innovation.**

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**ONLY 3% OF SMEs SOUGHT ADVICE ON EXPORTING IN THE LAST 12 MONTHS.**

**THOSE SEEKING TO INTERNATIONALISE ALSO DO NOT BELIEVE THEY HAVE SUFFICIENT ACCESS TO CAPITAL OR KNOWLEDGE ON HOW TO DO SO.**
Illustration of Internal Enablers

By comparison, internal enablers are perhaps less well developed among the UK SME business base. These internal enablers, combined with appropriate training, require greater attention if more UK SMEs are to initiate and/or intensify their international and innovation activity – and as a consequence increase their productivity.

One internal enabler for SMEs seeking to internationalise and innovate has been accessing knowledge and support. The majority of UK SMEs, however, state that they would not know where to seek support to expand internationally. Such ‘knowledge gaps’ about the availability of trade development products and services in the UK serves to quickly reduce the number of SMEs that actively engage in exporting63.

The 2015 Barclays Export Index revealed that only 3% of SMEs sought advice on exporting in the last 12 months64. Those seeking to internationalise also do not believe they have sufficient access to capital or knowledge on how to do so.

Addressing these information ‘failures’, therefore, becomes a necessary first step in encouraging SMEs to access capital, engage in international activity and increase productivity growth.

Another, arguably less-explored, internal enabler for internationalisation and innovation among SMEs has been their disposition or mindset for growth. A business owner’s growth ambition has proven crucial for SMEs to engage effectively in internationalisation and innovation. Leadership capability has been highlighted as a significant factor in this: if business-owners are unsure or fearful of the consequences of internationalisation and innovation, they adopt more conservative business strategies as they reduce their exposure to risk and may well miss their growth targets. By contrast, if a firm’s leadership is ambitious it is more likely to be innovative and look to expand internationally, which contributes positively to UK productivity growth.

The next section of the report will further explore the role of growth ambition as an internal enabler. Emphasis is placed on new evidence that demonstrates the importance of growth ambition in addressing the UK’s productivity problem.

60 Based on their diagnostics of client needs at the start of their customer growth journey with GrowthAccelerator. ERC and Business Growth Service (2015) “Growth Dashboard”, June 2015. The GrowthAccelerator data on barriers to growth were extracted for over 23,000 clients in May 2015 and cover the period April 2012–March 2015.
61 Driffield, N. et al. (2010) op. cit.
63 Driffield, N. et al. (2010) op. cit.
64 In a survey of 10KSB participants, 50% of businesses did not know where to get support to expand internationally.
Sherry Coutu CBE, Chairman of the Scale-Up Institute

Competitive advantage doesn’t go to the nations that focus on creating companies; it goes to the nations that focus on scaling them. The Scale-Up Report I was commissioned by the government to write in 2014 identified six ways in which we can improve the UK’s economic growth through policies that increase the number of companies that grow to scale in the UK.

Since large companies contribute more to productivity and economic growth than small ones, it makes sense to focus on the more established scale-ups as the engines of prosperity. The problem in the UK is that growing companies do not get the support they need to reach a significant size, which has been associated with their leaders being tempted to sell out early to US rivals. The report highlighted the challenges businesses face when seeking to scale in the UK and the support needed to reach significant size. Currently only 0.4% of businesses reach 250 employees or more in the UK, compared with 0.7% in the US.

The most critical capabilities that help to ensure a business scales up successfully are talent and leadership capabilities. Access to talent and educating company leaders to drive forward growth are seen as fundamental throughout all stages of a business’s growth, but particularly so when the company is growing quickly. Companies grow by first establishing a product and making it work – usually within one jurisdiction. They then need to export and drive their product into other jurisdictions to achieve further growth. From this, they may decide to start acquiring other businesses to continue growing in other jurisdictions. In this sense, ensuring businesses have the access to talent and leadership capabilities necessary becomes vital for growth. If you can solve the access to talent gap then you next need to ensure that the leadership team can develop their skills rapidly enough to meet customer demand.

That may sound simple, but it’s incredibly hard to grow a company at 20%, 30% or even 40% per annum.

In fact, you could think of a scale-up leader as not entirely dissimilar to an Olympic team – they are as rare or even more so and like Olympic teams businesses that are growing fast need specialist help. We need therefore, to look at business education in the same way that we look at training successful teams of Olympic athletes – by broadening the talent to choose from, hiring from all pools and ensuring there are excellent programmes, role models and coaches in place to nurture this.
Races need to be finished, plays need final acts and, for enterprises, starting up must also be followed by scaling up. There is a tremendous interest by both students and faculty in starting things. Starting is trendy, it’s sexy. Much harder is the process of growing further. We spend too much time and attention on starting and not nearly enough on scaling. At Oxford, we are trying to go beyond start-ups to help businesses pursue ambitious growth.

The university business school, in particular, has a fundamental role in shaping business leaders to think decisively about innovation and internationalisation. To some degree, business education is like advanced driving schools. We teach students how to operate one of the most powerful engines in the world: business. We teach how this engine might be finely engineered (operations), how it needs special fuel (finance), and how the parts need to work together (organisation and leadership). We teach how to monitor the gauges carefully (accounting), how to steer our vehicles at high speeds and through rough weather (strategy). Beyond that, we need to focus on where to drive - the mission and purpose of business.

Business education is far richer when business schools fully engage with their universities. While students must be grounded in the common MBA core of finance, accounting and other courses, opportunities in business can only be understood by those with some appreciation for topics far beyond the standard business curriculum.

For the past few years, I’ve asked chief executive officers and other business leaders: ‘What forces will transform business in 25 years?’ My experience is that they quickly converge on a set of topics that business schools don’t normally teach: demographic change, natural resource constraints, technological trends like big data.

We bring these important topics into our curriculum and into the intellectual lives of our students. Business education needs to encourage broader and more ‘connected thinking’ if we are to cultivate and develop the UK’s innovative businesses. At Oxford we hope our students learn not only how to ‘drive’ their businesses in pursuing ambitious growth, but, in turn, how to help our community find its way forward.
Smaller businesses are vital to our economy, contributing almost half of private sector turnover and over 60% of private sector employment. Addressing the challenges and obstacles they face in accessing the finance they need to start, grow and thrive is at the core of what we do.

The British Business Bank was set up with the aim of making finance markets work better for smaller businesses. We do this by increasing the supply of finance in areas where markets are less effective, creating greater choice of both supplier and finance product, and building smaller businesses’ confidence in understanding their options by providing improved information in the market.

By working through over 80 commercial lenders and investors, we’re able to bring in significant private investment alongside government money – our programmes currently facilitate £2.4bn of finance to over 40,000 small businesses, and we participate in a further £3.3bn of finance to mid-cap businesses.

There are encouraging signs that the market, in general, is beginning to improve, and certain areas have recently shown marked changes. Overall equity investment in small businesses is growing, and the use of non-traditional sources of finance has also seen strong growth – albeit from a small base. At the British Business Bank, we are strongly focused on catalysing these areas of the market, with over 75% of our lending and investment distributed through smaller providers, including challenger banks, debt funds and online platforms.

There is an ongoing demand from smaller businesses for increasing volumes of growth finance – both equity and debt. The British Business Bank is proud to play a growing role in the provision of early-stage equity in the UK, with our flagship Enterprise Capital Funds programme having an overall investment capacity of over £580m. Earlier this year, we launched our £100m Help to Grow pilot, working with private sector lenders to deliver growth loans to help fast-growing, established, small businesses fund their growth ambitions.

In order for smaller businesses to maximise their impact on economic growth, it is vital that those with high growth potential are able to get the right type of funding at the right time. We are focused on catalysing this essential finance and bringing about positive change in the markets in which we operate.

Access to finance is a key enabler for the growth of smaller business, and we’re committed to unlocking the finance they need to fulfil their potential.

Keith Morgan, CEO of the British Business Bank
Professor Mark Hart, Deputy Director of the ERC and Programme Director for 10,000 Small Businesses UK, Aston University

While many see a high start-up rate as evidence of entrepreneurial vigour, it is not the whole story. More than half of new businesses cease to trade within 3 years and, more importantly, the UK has a relatively poor record in building them into bigger companies.

The UK currently has a huge volume of micro enterprises coming into the market place, but we just can't grow them. Among the OECD group of developed nations, the UK has one of the lowest rates of start-ups with between one and nine employees that grow to 10 or more within three years.

When asking business owners about barriers to growth, often cited are external factors such as scarcity of skilled staff, or red tape and tax. However, one big problem lies closer to home: a lack of leadership and entrepreneurial skills. We have an issue over the capability of owners to grow the business and take it on to the next step.

The Goldman Sachs 10,000 Small Businesses programme has looked to address these concerns by providing high-quality, practical education and business support to leaders of small businesses and social enterprises with the potential to achieve high-growth.

Since 2010, we have reached almost 1,000 businesses across the country - playing a vital role in creating jobs and driving economic growth through innovation and market expansion. As a programme director at the Aston Centre for Growth, I aim to ensure that small business leaders are equipped with the knowledge and support they need to continue growing their businesses: both innovatively and expanding in the international arena. During the course of the programme every small business owner develops a customised Growth Plan to direct their organisation's business strategy and expansion.

It is through this engagement that we hope to inspire the UK's high-growth small businesses to strengthen their leadership capabilities and broaden their entrepreneurial skills to contribute to and promote further the UK as a competitive economy.
Mindsets and the Growth of SMEs

Introduction

An important internal enabler for growth in SMEs is the ambition of business founders and owner-managers to scale to the next level. To what extent do UK SME owners differ in their attitudes towards expanding their business compared to other advanced economies, such as the US? How do these attitudes towards growth serve to constrain engagement in internationalisation and innovation activity?

Is there a Growth ‘Ambition Gap’ in the UK?

Whilst the UK has seen the highest number of start-ups compared to the OECD average more than half of new businesses cease to trade within three years. The problem for the UK, therefore, is not in starting companies, but in growing them. Fig 9

Recent research from the Global Entrepreneurship Monitor Project in 2014 suggests that an ‘ambition gap’ has opened up between the UK and the rest of the G8 economies. The GEM Global project has created a metric that measures the growth expectations of early-stage entrepreneurs. From this we can see that the UK lags behind in terms of growth expectation compared to all but one of the G8 economies. Fig 10

GEM data also suggest an ‘ambition gap’ exists between the UK and the US for a number of years post-recession suggesting UK firms have lower levels of growth expectation. Figure 11 shows that between 2011 and 2014 around 1 in 6 of UK early-stage entrepreneurs (18%) had high job expectations compared to 27% in the US.

The suggestion here is that the UK has lost ground in the growth ambition stakes compared to the US in generating jobs and stimulating productivity growth.
Fig 9

GROWTH EXPECTATIONS OF EARLY-STAGE ENTREPRENEURS

<table>
<thead>
<tr>
<th>Country</th>
<th>6-19 jobs (% of TEA)</th>
<th>20+ jobs (% of TEA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>12%</td>
<td>18%</td>
</tr>
<tr>
<td>CANADA</td>
<td>10%</td>
<td>14%</td>
</tr>
<tr>
<td>FRANCE</td>
<td>14%</td>
<td>15%</td>
</tr>
<tr>
<td>GERMANY</td>
<td>13%</td>
<td>14%</td>
</tr>
<tr>
<td>RUSSIA</td>
<td>9%</td>
<td>14%</td>
</tr>
<tr>
<td>ITALY</td>
<td>5%</td>
<td>10%</td>
</tr>
</tbody>
</table>


Fig 10

START-UPS SINCE 2007

<table>
<thead>
<tr>
<th>Country</th>
<th>% of TEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>27%</td>
</tr>
<tr>
<td>OECD AVERAGE</td>
<td>23%</td>
</tr>
<tr>
<td>US</td>
<td>25%</td>
</tr>
</tbody>
</table>

Source: OECD


66 Defined as those individuals in the process of starting a venture and those running a new business less than three years old – the GEM TEA index.

67 Note the GEM Global Monitor Project 2014 did not include Japan.


69 This would appear to be a problem observed for the economies of France and Germany as well in 2013 and 2014.

70 This is a slightly different definition of high expectation entrepreneurship than the one used in the G8 comparison. To identify individuals who expect to create a relatively high number of jobs, GEM created a variable which measures the percentage of all early-stage entrepreneurs who have created more than ten jobs and who expect more than 50% growth in jobs in the next five years. The GEM measure is a measure of expected, not realised, growth and of 50% over five years.
Recent research, which summarised the results of a range of international studies, has shown that the growth ambitions of SMEs matter to productivity growth. In this, tracking the performance of a firm over a number of years, subsequent to catching their growth ambition, shows that there is a positive relationship between growth ambition and productivity growth. Another consistent result is that innovation and exporting are associated with growth intentions.

Closing the Ambition Gap by Supporting More Businesses to Become Growth-Inclined

A new study in the UK suggests that looking at intangible factors – such as the attitudes or ‘dispositions’, aspirations, behaviours or past experiences of business owners – may be just as important in helping to explain small business performance as focusing on more tangible issues such as access to finance and skills.

Three broad identifiable categories of business owners are focused on: the growth-inclined, the growth-ambivalent and the growth-resistant. Growth-inclined businesses have demonstrated openness to engaging in internationalisation and innovation, while growth-ambivalent and growth-resistant business owners have typically avoided this activity.

Business owners disposed to growth are also more likely to think and act strategically – ensuring international activity is a well-developed aspect of their long-term business plan.
Growth-inclined owners are also more likely to have a positive relationship with exporting and innovation:

- **Exporting**: Growth-inclined owners tend to be the most positive towards exporting – either exporting a small amount and planning to increase in the future, or already with a high proportion of exports in their turnover. They were also more likely than the other two groups to report that exporting had been central to their business model from the start.

- **Innovation**: Growth-inclined owners were generally more positive about the benefits of using technology and more confident in their own abilities to do so. In addition, they were more open to innovation or diversification. Formal innovation (such as new products or services) was relatively rare, but the growth-inclined owners tended to be receptive to, have knowledge of, and endorse the use of a wider and more innovative potential range of products/services (for example, peer-to-peer lending, use of iPads, making more use of Skype rather than mobile phones or landlines). As one growth-inclined owner put it:

> “I don’t suppose we’re innovators. We are adopters of other people’s innovation and we are resellers of other people’s innovation so for us it’s about stealing the march on your competitors by being an early adopter. For that you’ve got to have some confidence in the products that you’re dealing with.”

Growth-inclined owner

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Growth-ambivalent business owners currently can be characterised by an ‘opportunistic’ or ‘ad hoc’ approach to growth, lacking a comprehensive exploration or exploitation of the full range of possibilities open to them.

There is evidence to suggest that interventions which enhance the individual skills of SME owners (such as through increased education or innovative programming) can have a positive impact on growth disposition. In particular it forms a positive mindset towards expansion and leads to an updating of strategic behaviours and management practice.

If more UK SMEs can become more growth-inclined then their businesses will start to exhibit very different behaviours, which will provide a more solid platform for achieving growth and in turn increasing productivity. Fig 12

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Growth-inclined businesses have demonstrated openness to engaging in internationalisation and innovation.

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Case Study of a Growth-Inclined Business

Byron Dixon, 10KSB UK participant

Byron Dixon is a former lab technician and chemistry-enthusiast who launched his business, Micro-Fresh, in 2009. Micro-Fresh was originally developed to stop leather goods going mouldy while they were being shipped from the far corners of the world. As well as protecting leather sofas, shoes and bags, Byron discovered it could safely be used as a non-toxic anti-bacterial formula to stop smells and germs in everything from uniforms and footwear to workwear, gym equipment, car seats and work surfaces.

Micro-Fresh is just one example of a small business that has benefited from substantive growth through expanding operations into the international arena. Within the first year, the business had expanded into China. Six years on and the company is operating across the globe - including in countries such as India, Jamaica and Portugal.

Byron is now hoping to tap in to the vast American market, where there is a huge demand for anti-bacterial products - particularly since the Ebola outbreaks in West Africa. ‘I went over to the US in November and was able to speak to representatives of lots of huge corporations including Google, Microsoft and Honda. As a result we are opening offices in Delaware and Atlanta. It’s the first time we’ve been in the States, but we are already in China, India, Portugal, Jamaica, Singapore and Vietnam.’

Export opportunities have become increasingly important to Byron, as Micro-Fresh looks to expand into new markets. ‘There is still a lot to do in the UK, but the big growth is overseas.’ Thanks to the company's expansion into new countries, Micro-Fresh is currently growing at an average rate of 45% year on year. Byron is confident of the enhanced opportunities for his company in entering into new markets: ‘There are some huge companies in the States and we hope at least one of them will be carrying the brand next year.’
10KSB UK Participants and Internationalisation and Innovation

Who are the Participants?

Overall, around 1000 SMEs have participated in the 10KSB UK programme since 2010. Before understanding their degree of internationalisation and innovation activity, it is useful to provide some detail of the characteristics of the firms and the owner-managers who undertook the programme.

Source: Goldman Sachs 10,000 Small Businesses Programme Monitoring & Evaluation Surveys (2012-15)
Firm Characteristics:

› Participants are mostly established businesses with only 23% less than five years of age and it is a criterion of the programme that participants must be trading for at least 2–3 years.

› In terms of employment size 58% of the participants employed fewer than 10 people when they started the programme and are, therefore, classified as micro-enterprises. Only 3% employ more than 50 people.

› A quarter of the participants have annual revenues of over £5m while almost a third (31%) have an annual revenue of less than £500k.

› Most of the businesses (45%) are in the business service sector with a further 18% in manufacturing and 8% in the retail and wholesale sectors. The remainder are in a range of sectors including personal services and construction.

Owner Characteristics:

› A third of the participants are women (32%).

› A fifth of the participants are aged over 50 with 41% aged between 40 and 49 years.

› A large number are degree educated (61%).

› A high proportion (38%) have run a business before their present one.

› The majority of participants (74%) had founded the business they took through the programme.
The export activity of the 10KSB UK participants is truly global with many of the small businesses currently operating in multiple markets. Fig 12

While the EU dominates the export activity of the respondents (84%), there is significant activity in every other continent. In particular, Asia has demonstrated itself as an important export destination for a third of participants and is of note in the light of UK government initiatives late in 2015 to develop China as a key export market for UK SMEs.

The same global profile emerges when we look at international activities, not just exporting: 29% of participants are currently operating internationally with 76% concentrated in the EU, 53% in the US and Canada, and 39% in Asia. Fig 13

Furthermore, the businesses are more likely to export from the beginning of their business or within early years of trading. One in five exporters have been involved in exporting activity since their business was

Currently, 36% of 10KSB UK participants are exporting to international markets – almost double the proportion observed in the general UK business population (19%). In addition, a further 6% of participants are currently operating in international markets which include such activities as international acquisitions, establishing overseas offices, subsidiaries, joint ventures, sourcing products, supplies from overseas.

Overall, therefore, just over two-fifths of the participants are internationally focused.

Fig 13
established with a further quarter starting overseas trade activity within the first two years of start-up. Evidence has suggested that there is a positive relationship between early entry into overseas markets and faster business growth.

One in ten respondents could be categorised as ‘late’ exporters – developing trading activities outside the UK 10 years after having set up their business.

The decision to start exporting, however, has not always been the product of a considered business strategy. Instead, three-fifths (58%) indicated that they had begun to export as a result of a chance event. Interestingly, ‘early’ exporters were more likely than ‘late’ exporters to have started exporting as part of a clear business strategy and not as a result of a chance occurrence.

Despite this, the connection to exporting activity and growth is prominent. Two-fifths (39%) of exporters reported that in the last 12 months their export sales have been increasing.

10KSB UK businesses are much more likely to be involved in export markets than similar groups of small businesses in the UK. It is no coincidence that they have also demonstrated faster growth than their UK counterparts.

However, they are not a homogeneous group of small businesses and a picture is beginning to emerge among the 10KSB UK participants of two types of exporters:

- Owners who started exporting almost immediately when they started their business and did so as part of a clear business strategy. They tend to have a higher proportion of their current sales from export markets.

- Owners who started exporting many years after the business had established itself in the UK market place and had done so as a result of a chance occurrence. They tend to have a smaller proportion of their current sales from export markets.

Both types of business owners highlight challenges they face in exporting their products and services outside the UK. Fig 14

Source: Goldman Sachs 10,000 Small Businesses Participant Survey (2015)

73 These data come from a survey of the 10KSB participants in July 2015. All 933 participants were invited to complete the online survey and overall 313 responses were received – a response rate of 34%.

74 Jack Ma, founder of Chinese e-commerce company Alibaba, will advise the UK Government on encouraging more UK SMEs to export to China.

Programme Contribution

The 10KSB UK programme encourages participants to develop their business model to achieve growth outside the UK market place. The challenge to all participants on the programme is to re-visit the vision of their business and assess the potential for them to become truly global. The Business Growth Plan is the vehicle for this re-calibration of the business objectives.

10KSB UK and Innovation

Participants Innovate More

The M&E surveys of all the 10KSB UK participants are undertaken on a regular basis once they complete the taught element of the programme and deposit their Business Growth Plan. These surveys include three main questions based on standard questions on innovation asked in the European-wide Community Innovation Survey (CIS).

In the last 12 months did the business:

› Launch a new product or service?
› Research or develop a new product or service?
› Improve the quality of an existing product or service?

It is clear that the level of innovative activity is significantly higher for 10KSB UK participants than in SMEs generally in the UK. Fig 15 The EU Innovation Scorecard demonstrated that around 25%-28% of UK SMEs were innovative which was lower by a factor of three when compared to 10KSB UK participants. Just over 80% of participants had improved the quality of an existing product or service in the previous 12 months when asked just six months after they had completed the programme.

More importantly, innovation, using these three measures, has continued to increase among participants long after their participation on the programme.

Figure 16 shows that a large proportion of this innovative activity is attributed by the business owners to their participation in the programme. Even more than two years after businesses participated in the formal teaching of the programme, over half the participants still attribute their innovative activity to the 10KSB UK programme.

Programme Contribution

Innovation is an important component of the programme. From the outset participants are encouraged to review their current products, services and internal processes to ensure that they are competitive in their markets, as well as considering new opportunities for growth and how to develop a culture of innovation in the business.
10KSB UK Participants and Internationalisation and Innovation

INNOVATIVE ACTIVITY IN THE LAST 12 MONTHS/SINCE COMPLETING THE 10KSB PROGRAMME

<table>
<thead>
<tr>
<th>Duration</th>
<th>LAUNCHED A NEW PRODUCT OR SERVICE</th>
<th>RESEARCHED OR DEVELOPED A NEW PRODUCT OR SERVICE</th>
<th>IMPROVED THE QUALITY OF AN EXISTING PRODUCT OR SERVICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 MTHS</td>
<td>83%</td>
<td>68%</td>
<td>61%</td>
</tr>
<tr>
<td>18 MTHS</td>
<td>84%</td>
<td>70%</td>
<td>70%</td>
</tr>
<tr>
<td>30 MTHS</td>
<td>90%</td>
<td>80%</td>
<td>84%</td>
</tr>
</tbody>
</table>

Fig 15

% OF RESPONDENTS ACHIEVING INNOVATION ACTIVITY AS A RESULT OF THE 10KSB PROGRAMME

<table>
<thead>
<tr>
<th>Duration</th>
<th>LAUNCHED A NEW PRODUCT OR SERVICE</th>
<th>RESEARCHED OR DEVELOPED A NEW PRODUCT OR SERVICE</th>
<th>IMPROVED THE QUALITY OF AN EXISTING PRODUCT OR SERVICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 MTHS</td>
<td>44%</td>
<td>55%</td>
<td>70%</td>
</tr>
<tr>
<td>18 MTHS</td>
<td>53%</td>
<td>64%</td>
<td>53%</td>
</tr>
<tr>
<td>30 MTHS</td>
<td>50%</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

Fig 16

Source: Goldman Sachs 10,000 Small Businesses Programme Monitoring & Evaluation Surveys (2012-15)

76 The 10KSB UK Monitoring & Evaluation surveys are undertaken for the Goldman Sachs 10,000 Small Businesses Programme by an independent Market Research company (BMG Research Ltd).

77 This is now called the UK Innovation Survey (UKIS) in the UK.
How do 10KSB UK Innovators and Exporters Perform?

To what extent do 10KSB UK participants who engage in exporting and innovation grow faster compared to those participants who do not engage in these activities? The analysis is undertaken over the period 2010-2014 and all programme participants have been linked to the official ONS firm-level datasets in the UK to allow annual tracking of their employment and revenues\textsuperscript{78}.

For those 10KSB UK participants who both innovate and export and have recorded productivity growth compared to those participants who neither export nor innovate\textsuperscript{79} whose productivity has broadly remained unchanged. \textit{Fig 17}

There is no information on the intensity or duration of innovation and exporting activity among the 10KSB participants which means that the analysis may only be picking up the productivity effects of a ‘light touch’ engagement in these activities. Nevertheless, the evidence from this small group of fast-growing 10KSB businesses is that there is a positive association between innovation, internationalisation and growth\textsuperscript{80}.

By way of context, all participants have grown strongly in the post-recession period in terms of employment and revenues which corresponds to when they had the opportunity to participate in the 10KSB UK programme. However, revenue growth was not as strong as their employment growth between 2010 and 2014 and, therefore, their productivity growth (i.e. revenue per employee) is flat – except for those who both export and innovate.

While the business population in the UK is now recorded as over 5 million the actual number of businesses with high growth potential is significantly smaller. In the context of the 10KSB UK programme the actual number of eligible businesses (i.e., at least 5 employees with a trading record for at least 3 years) was around 40,000 which serves to illustrate that the ambition to scale the programme is realistic and can deepen the impacts set out above. \textit{Fig 18}
HOW MANY GROWTH POTENTIAL SMEs IN THE UK?

ALL UK SMALL BUSINESSES, 2014
5,243,000

...LESS BUSINESSES WITH NO EMPLOYEES
1,277,000

...LESS STARTUPS (BUSINESSES FOUNDED 2013)
992,000

...LESS BUSINESSES WITH 1 TO 3 EMPLOYEES
492,000

...LESS BUSINESSES OUTSIDE 10KSB REGIONS
423,000

...LESS BUSINESSES THAT DID NOT GROW IN 2012
129,000

...LESS BUSINESSES WITH SIMILAR HISTORICAL GROWTH TO 10KSB UK PARTICIPANTS
39,800

Source: ONS Business Structure Database (BSD)

Fig 18

78 All employment and revenue data are sourced from the longitudinal ONS Business Structure Database (BSD) which is based on annual extracts from the Inter-departmental Business Register (IDBR). This database covers all registered businesses (i.e. VAT and/or PAYE) in the UK. Data on innovation and exporting are sourced from the 10KSB Monitoring and Evaluation surveys conducted 6, 18 and 30 months after completion of the programme.

79 Sample size is 174 businesses for this analysis (35 innovators and exporters and 139 non-innovators and non-exporters).

80 This can be assessed more rigorously with increased sample sizes and additional years of data.
“Productivity is the challenge of our time. It is what makes nations stronger, and families richer. Growth comes either from more employment, or higher productivity. We have been exceptionally successful in recent times in growing employment. We are proud of that. But now in the work we do across government we need to focus on world-beating productivity, to drive the next phase of our growth.”

Rt. Hon George Osborne and Rt. Hon Sajid Javid

Improving SME productivity is central to meeting the challenge set out by the UK Government.

The Government’s ‘Exporting is GREAT’ campaign launched during Export Week outlines an agenda for growth among SMEs encouraging 100,000 new exporters by 2020. We support this 5-year long campaign to inspire a generation of current and future businesses to export their products and services. We also recognize the achievements of Innovate UK in helping drive UK innovation and acting as a global showcase. Together, these initiatives are key in helping to grow UK SMEs.

This report demonstrates that internationalisation and innovation are fundamental drivers in boosting productivity among UK SMEs. High level estimates suggest that an improvement in exporting alone would add £1.15bn to annual GVA.

Significant advancements have been made in recent years to create a business environment conducive to high growth. We commend the many initiatives focusing on this, including but not limited to, programmes such as the Business Growth Service, Innovate UK and the work of UKTI.
Yet, the UK lags behind many of its competitors in the G8 in terms of the share of high-growth SMEs. The report focuses on a number of structural barriers we need to address in order to boost SME growth. Our assertion is that there is a growth ambition gap. Addressing this for those SME’s looking to grow is essential.

Our recommendation is threefold:

1. The overall entrepreneurial ecosystem needs to be nurtured to encourage greater growth ambition among SMEs.

   - **Ecosystems and infrastructure** need to be supported and enhanced to encourage and stimulate SMEs. This includes, but is not limited to:
     - The support of the **private sector** and the opportunity for expanded scale and impact through the establishment of **public-private partnerships** to deliver world-class business support to SMEs.
     - **The role of national and local government** in supporting and encouraging SMEs. Credit should go to the UK Government and its recent initiatives, including the Government’s Business Growth Service, UKTI, Local Enterprise Partnerships and the finance organisations referenced in this report for their work in this area.
     - **Broadening international links**. Opportunities to improve connections between SMEs globally help to ensure the cross-fertilisation of ideas, markets and ambition. The Silicon Valley Comes to Oxford (SVCO) programme is a powerful example.

   - **Strong ecosystems take time to develop.** For long-term growth success, it is vital these frameworks look to provide sustained and holistic support to SMEs.

   - **We applaud the establishment of the Scale-Up Institute and support its desire to work with and engage the UK entrepreneurial ecosystem at national, regional and local levels, in support of businesses scaling up.**

2. **We need to expand and increase appropriate forms of education to help build the UK’s entrepreneurial ecosystem.**

   - **Practical and impactful business education for SMEs is fundamental in providing SMEs with the appetite to internationalise and innovate.** The evidence shows that having the right leadership and entrepreneurial skills, combined with talented staff, makes it more likely that the growth ambition of SMEs will be realised.

     - We need to ensure that there are a wide range of accessible support programmes to businesses with a desire to grow. Recognition should go to programmes such as Cranfield University’s Business Growth and Development programme, Santander’s Breakthrough programme as well as its recent Growth Advantage programme (GAP) in Scotland, which have developed in recent years.

     - Further work needs to be done to increase awareness of these programmes - including a greater drive towards ensuring business owners participate in such courses. Peer-to-peer networks and illustrative success case studies are one such way of accomplishing this.
• Holistic support for SME growth should also be based on a long-term and intensive relationship between programme staff and the SMEs in these programmes. One key advantage of this type of approach is the intimate knowledge which the education provider has of the SME and its needs. This builds trust between the small business owner and programme staff, something which is crucial to their willingness to accept advice.

• Supporting growth-oriented SMEs with their rapidly changing needs and strongly individual requirements through such programmes requires intensive engagement. The financial returns are substantial, however, with evidence from schemes in the Netherlands (Growth Accelerator), Denmark (Growth Houses) and initiatives in the UK (GS 10KSB) suggesting strong growth returns.

• Such programmes should emphasise the opportunities latent in internationalisation and innovation. Examples could include webinars with overseas counterparts explaining how to develop business or export to that market.

> **Advancements in online and blended learning programmes** make it easier for business owners to access such programmes. The Goldman Sachs 10,000 Small Businesses UK programme will launch an innovative online platform to address this need. The programme will offer a combination of both in person peer-to-peer learning and online seminars - increasing the accessibility and reach so that all growth-oriented businesses throughout the UK are able to participate.

> **We need to have a long-term agenda to build the next generation of ambitious entrepreneurs and talent.** Training across the education system is needed to support the enterprise education agenda. Specific focus should be on developing entrepreneurial skills through experiential learning in the context of real business situations. This will build and generate entrepreneurs of the future. The creation of the Careers and Enterprise Company is a key opportunity to develop and grow the skills and awareness of young people.

> **Management apprenticeships** can be an important vehicle to enhance the skill base of growth orientated SMEs. Initiatives such as the Holt Academy should be supported and replicated to build the base of skilled apprenticeships.

> **Training can also serve the broader ecosystem** in helping to develop and enhance the skills needed to support SMEs. We welcome the new training programme to be provided in 2016 for Local Enterprise Partnership (LEP) leaders in developing the necessary skills to support and enhance the UK entrepreneurial eco-system.

> **3. Capital is a critical enabler**

Much has been done in recent years to expand the pool of growth capital available. This has been seen through the expansion of the angel investor community driven by Government support schemes (such as SEIS and EIS), the creation of the private sector backed Business Growth Fund, or the work the British Business Bank in supporting diverse forms of finance such as peer-to-peer lending. This is strong and positive progress, but the UK still lags behind its US counterparts in equity usage.
Conclusion: What Can be Done to Boost SME Productivity in the UK?

Further finance is needed to support growth:

➢ We must ensure that SMEs are able to access the debt and equity finance they need to achieve their growth ambitions.

  • The British Business Bank has a specific remit to make the UK’s finance markets work better for those SMEs. To help deliver a more diverse and vibrant supply of finance in the UK the British Business Bank has expanded existing programmes, for example, the Enterprise Capital Fund programme. This has been expanded with an increase in the maximum equity investment size.

➢ We support the British Business Bank in rolling out new programmes to help SMEs scaling up access the capital they need. ‘Help to Grow’ was launched earlier this year, in which the British Business Bank is working with delivery partners to deliver debt-based finance for growing firms. Second, the ENABLE programme, which provides guarantees and capital funding to support challenger banks and asset finance providers.

➢ The British Business Bank is working with UK Export Finance to explore solutions for SME’s looking to internationalise and with Innovate UK to enhance financing for innovative companies.

➢ Greater efforts are needed on the demand side to build awareness and understanding of the range of finance options for growth-oriented firms.

  This needs to take into consideration the different ownership and board configurations of SMEs (e.g., family owned firms, management buyouts). In addition, we need to ensure SMEs are not discouraged from seeking external capital as a result of a perception that they will be unsuccessful.

  • Finance providers and other support programmes can help make businesses aware of the options available. For example, the British Business Bank, together with ICAEW Corporate Finance Faculty has produced the Business Finance Guide – a unique guide that outlines sources of finance available to businesses.

  • The British Business Bank’s new referral initiative will help SMEs by obliging banks to offer any business whose loan application they have rejected a referral to a choice of new online platforms. These online platforms will put referred businesses’ requirements in front of a range of alternative finance providers, who will have the opportunity to offer them the finance they need.

Businesses need to be provided with the right investment readiness advice if they are considering raising capital to determine if it is an appropriate fit for their business. In particular:

➢ How their growth objectives, and the importance of retaining control, might affect decisions to look for Venture Capital (VC) and non-bank source funding.

➢ How to choose between alternative forms of non-bank finance, such as VCs, private equity, and business angels, and how these different forms of financing variably affect firm performance.

In summary, the contributors to this report are committed to supporting the performance of SMEs in the UK. Drawing on the latest available evidence, it aims to bring the public and private sectors together to identify both the internal and external enablers for SME growth through greater internationalisation and innovation. We hope that it will stimulate further ideas and initiatives that will help our SMEs thrive in the future.
Surveys of 10KSB UK Participants

Overall, evidence from a number of bespoke surveys of the 10KSB UK participants has been used in this report.

Two online surveys of all participants on the Goldman Sachs 10,000 Small Businesses Programme UK was designed and implemented by the Aston Centre for Growth in July and August 2015. They were designed to capture evidence on the scale of their international activity and the nature of the barriers that are preventing them from growing faster. The surveys followed Market Research Society guidelines and the anonymity of each participant was assured. In total 922 invitations were sent out via Survey Monkey and by the close of the survey 313 responses were received to the first survey and 365 responses to the second. This represented response rates of 34% and 40% respectively.

For monitoring and evaluation purposes standardised interviews are conducted with participants by BMG Ltd when they begin the programme (the ‘baseline’ survey) and then approximately 6, 18 and 30 months after core programme completion. Interviews are conducted by CATI (telephone), which has proven to deliver the highest response rates (between 85 and 90%) and best data quality.

Co-Authors

Goldman Sachs Foundation and 10,000 Small Businesses UK Programme – The 10,000 Small Businesses programme is an investment by the Goldman Sachs Foundation to provide high quality, structured and practically focused support to small business leaders who are seeking to grow their businesses with a view to growing economies. The programme is designed specifically for the leaders of established small businesses who have the ambition and the potential to generate substantial growth in their enterprises. Participants benefit from a full package of support with a strong focus on structured peer learning and the creation of communities of entrepreneurs.

British Business Bank – The British Business Bank was launched in 2012 with the aim of making finance markets work better for small businesses in the UK at all stages of their development: starting up, scaling up and staying ahead. The British Business Bank is 100% Government owned, but independently managed. It brings expertise and Government money to the smaller business finance markets. They do not lend or invest directly. Instead, they work with over 80 partners such as banks, leasing companies, venture capital funds and web-based platforms.

Enterprise Research Centre – The ERC is an independent research centre which focuses on SME growth and productivity. The ERC is a partnership between Warwick Business School, Aston Business School, Imperial College Business School, Strathclyde Business School and Birmingham Business School. The Centre is funded by the Economic and Social Research Council (ESRC); the Department for Business, Innovation & Skills (BIS); Innovate UK; and, through the British Bankers Association (BBA), by the Royal Bank of Scotland PLC; HSBC Bank PLC; Barclays Bank PLC and Lloyds Bank PLC.