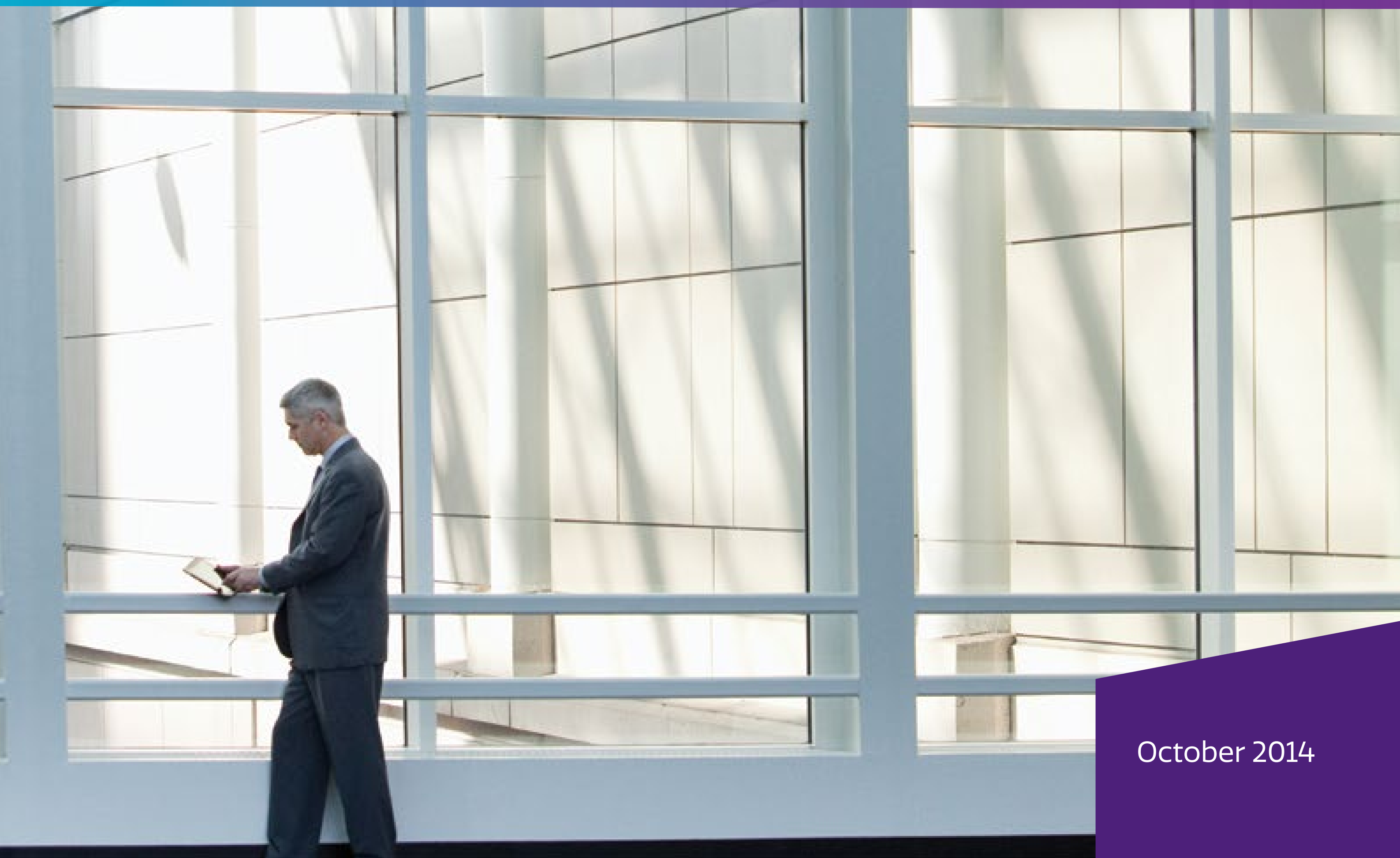
GROWING PAINS

How the UK became a nation of "micropreneurs"



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CONTENTS

INTRODUCTION

In 2013, the UK economy grew at its fastest rate since the recession (1.9%, ONS). This year, it looks set to exceed this record, with the Bank of England and a number of think tanks – including the EY ITEM Club – predicting upwards of three per cent growth in GDP during 2014.

Yet, the message from UK Plc is that conditions remain tough, and reports suggest that the Government's fast lanes to growth (including exporting) are not yet reaching their full potential. In August 2014, the British Chambers of Commerce (BCC) predicted that the Government would miss its target of doubling UK exports by 2020.

With so much uncertainty surrounding the future growth of the UK economy, it is important to understand what's driving the private sector's contribution to UK GDP. The UK is undoubtedly a great place to start a business; but is the Government doing enough to turn these promising young ventures into mighty oaks?

We decided to take a closer look at UK enterprise, breaking it down by different size categories and modelling its pace of change. By analysing the landscape in this way, beyond the simplified view of SMEs vs. corporates, we can determine: the shape of UK business; what this shows about the speed of UK economic recovery; current conditions for business growth; and SMEs' demands for Government support.

The findings are illuminating; the UK has become a nation of micro businesses, many of which are zero-employee firms with lower potential than 'traditional' start-ups to expand their business and hire additional people. At the same time, the proportion of high-growth businesses in the UK has plummeted, and many small businesses are now calling on the Government to help them achieve their growth aims.

While the proportion of high-growth businesses in the UK is set to recover, the aftershocks of recession are still being felt. We hope this study helps small businesses to realise their growth ambitions, whatever they might be; encourages small business advisers to help their clients make more growth-oriented decisions; and enables the Government to better understand SMEs' needs.

SHRINKING ASSETS

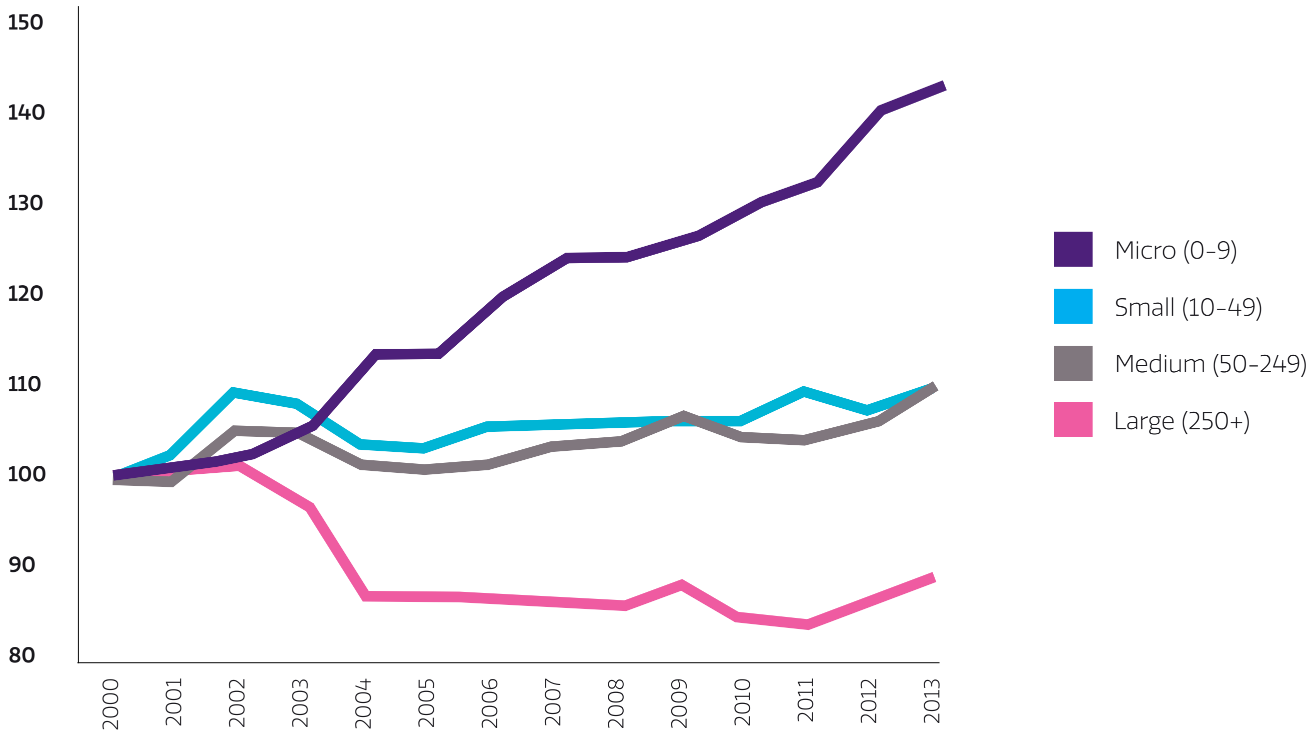
UK businesses are becoming increasingly micro in size – reducing the overall potential for economic output and future growth, and increasing the economy's reliance on a relatively small number of larger businesses.

The proportion of businesses classified as 'micro' (0-9 employees), as a share of all UK businesses, has grown since the turn of the millennium, while the proportion of all other business size categories has diminished. As a result, micro businesses now account for 95.4 per cent of all private sector companies, up from 94.3 per cent in 2000.

Looking at this category in isolation, the UK has added 1.4 million micro firms – an increase of 43 per cent – to the business landscape since 2000.

Growth in micro firms has far outpaced that of small and medium ones

Number of UK enterprises, by employment size class, 2000-13, index 2000=100%



Source: BIS Business Population Estimates, Cebr analysis

SHRINKING ASSETS

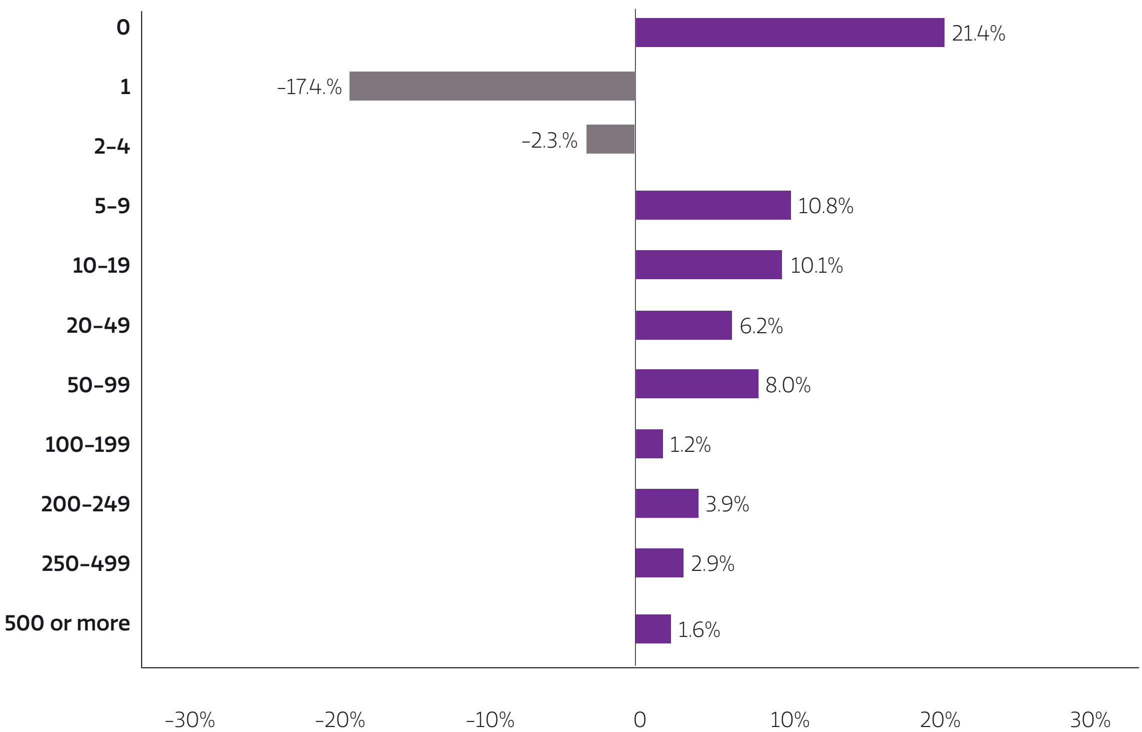
Taking a closer look at the smaller end of UK businesses, this micro trend becomes even more pronounced; zero-employee firms account for a significant 75.3 per cent of the micro-small business size category (0-49 employees).

At first glance, it could be argued that this is due to an increase in entrepreneurialism – which is typically characterised by high risk, high growth and high profit. However, as the following graph shows, this is more likely to be associated with the repercussions of the recession and people increasingly choosing to be self-employed.

The number of zero-employee firms in the UK has grown by 21.4 per cent since 2007, compared with a drop in the number of businesses with one employee of 17.4 per cent and two-to-four employees of 2.3 per cent. This implies that there has been a rapid growth in the prevalence of working proprietors.

Zero-employee firms have driven recent growth in micro enterprises

Percentage growth in number of UK enterprises, by detailed employment size class, 2007-13



Source: BIS Business Population Estimates, Cebr analysis

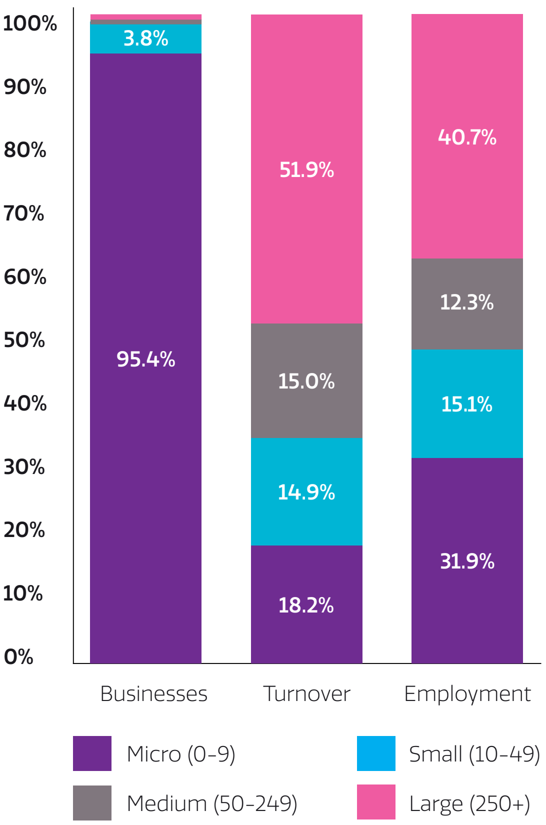
SHRINKING ASSETS

This 'new normal' is troubling news for the economy – because the numerical dominance of micro firms is not reflected in their turnover. Large firms, despite making up less than 0.1 per cent of the total private sector stock, account for more than half of all turnover and more than 40 per cent of UK private sector employment.

In fact, turnover per employee grows in line with employee numbers, with 250-499 being the optimum size for maximum output. This suggests that supporting the growth of smaller firms should enable expansion and investment, which would markedly improve their contribution to the UK economy.

However, the numerical dominance of micro firms is not reflected in turnover

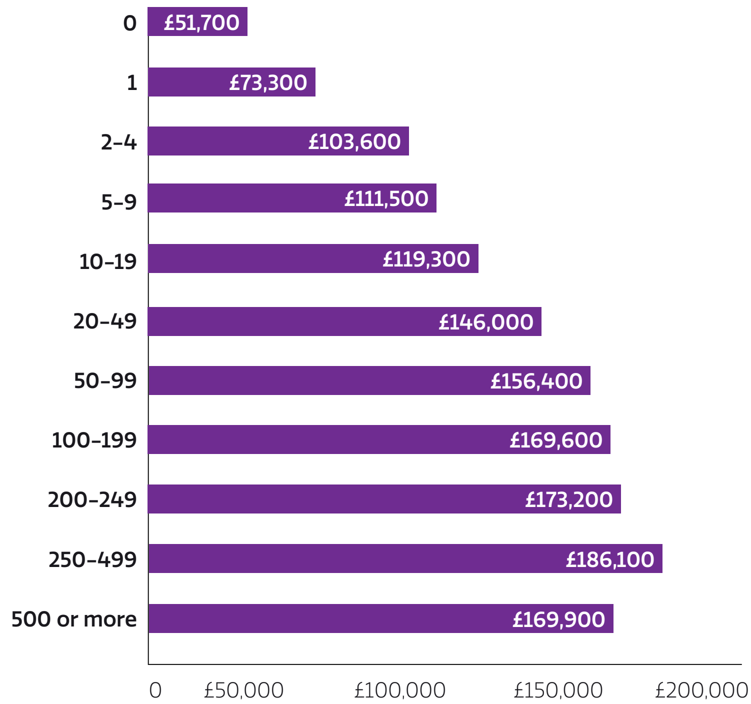
Proportions of UK private sector businesses, turnover and employment, by employment size class, 2013



Source: BIS Business Population Estimates, Cebr analysis

For SMEs, turnover per employee rises alongside firm size

Turnover per employee of UK private sector firms, by detailed employment size class, 2007-13



Source: BIS Business Population Estimates, Cebr analysis

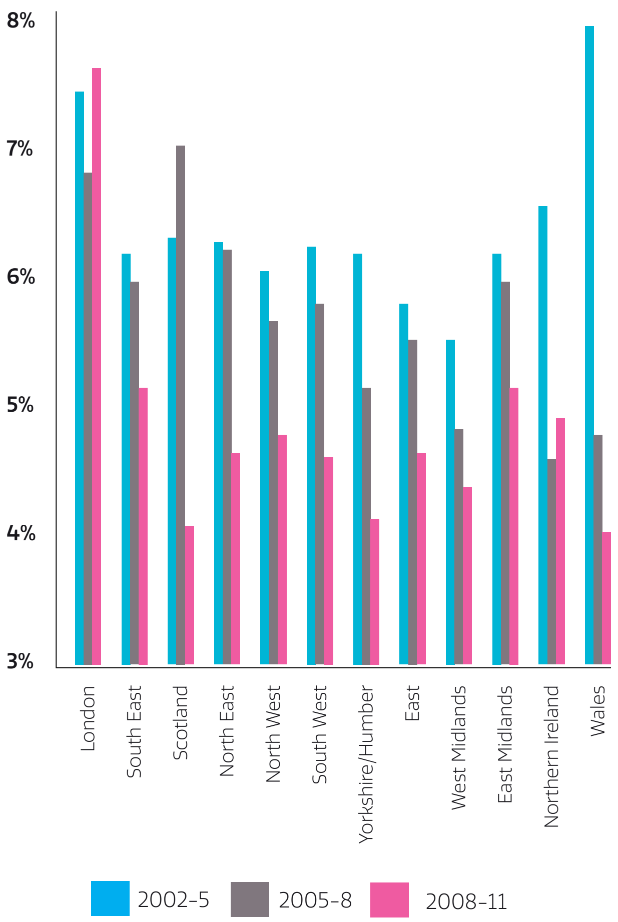
SHRINKING ASSETS

At the same time, the proportion of high-growth enterprises has declined sharply, falling by more than a fifth in the majority of regions since 2005, according to the latest available data.

Looking ahead to 2017, the proportion of high-growth firms is expected to rise again, as a result of improving economic conditions. Optimists beware, however: performance is expected to remain below 2005 levels in all regions except London, with the capital having already recovered its 2005-proportion of high-growth businesses by 2011.

The incidence of high-growth enterprises has declined in recent years

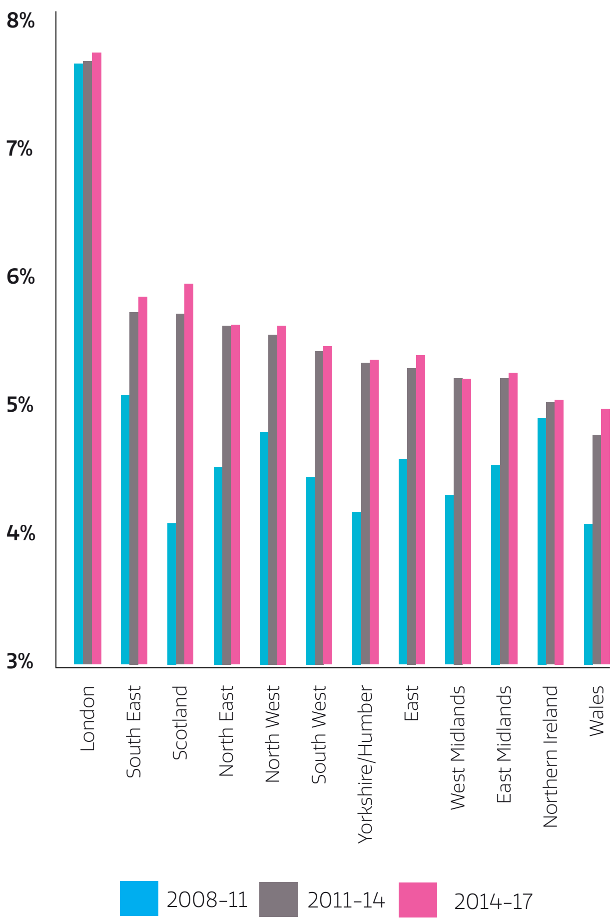
Proportion of high growth firms, by region, 2002-11



Source: NESTA, ONS, Cebr analysis

However, their prevalence is expected to rise across all regions in the future

Proportion of high growth firms, by region, 2008-17



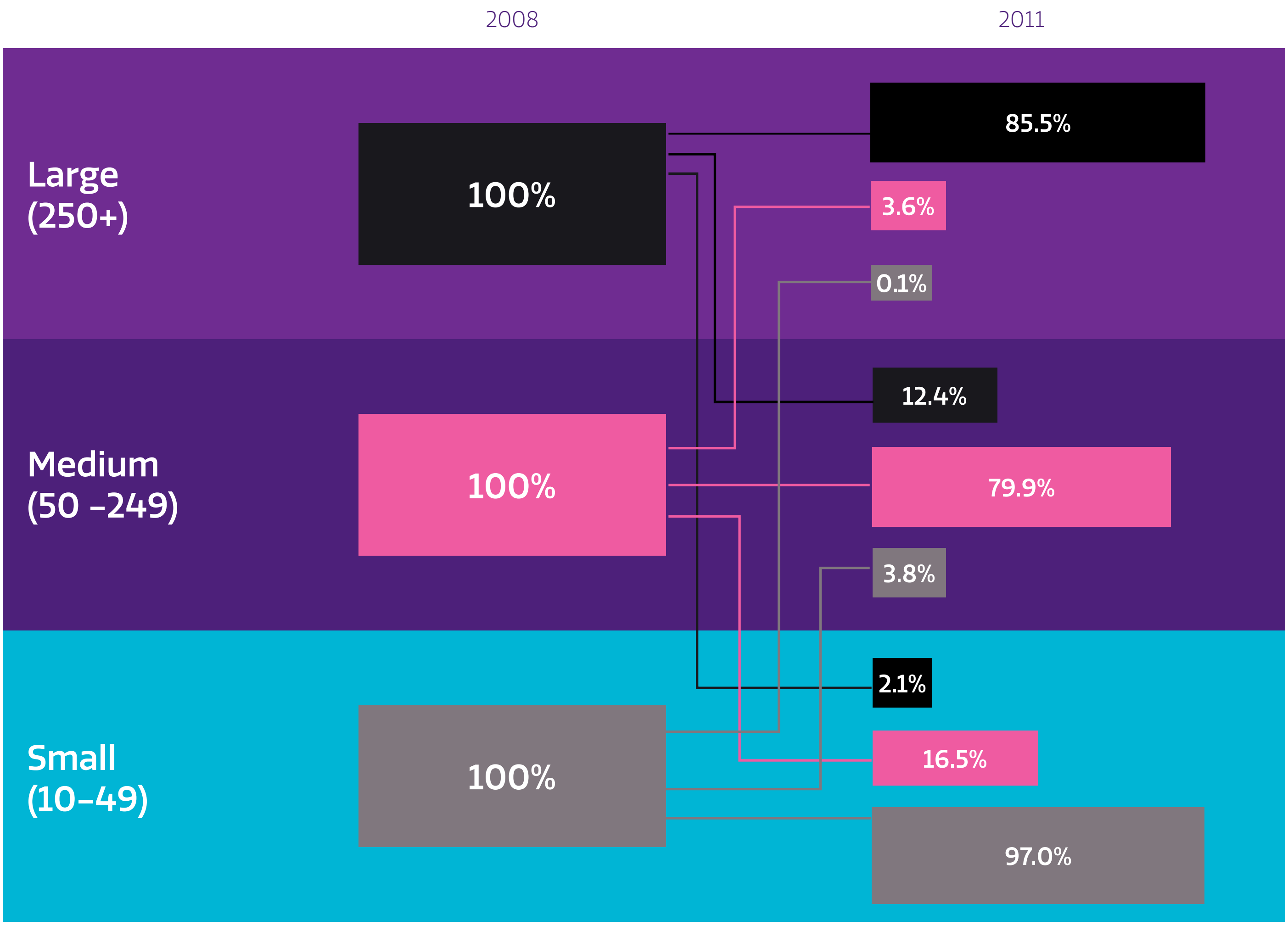
Source: NESTA, ONS, Cebr analysis

SHRINKING ASSETS

It is not only small businesses whose growth prospects are suffering; medium sized firms are more likely to have been reclassified as small (10-49 employees) than they are to have become large (250+ employees) since 2008, according to the latest available data.

Graduating between size bands remains difficult

Surviving enterprises' flows between size bands, 2008 to 2011



Source: ONS Business Demography, Cebr analysis

BARRIERS TO GROWTH

Starting up a company is incredibly difficult, and it has been getting harder in recent years to survive the first few years in business. According to the study, the majority (55%) of new businesses don't survive beyond five years.

There has been a significant downward trend in one-to-five year business survival rates since the recession, according to the latest available data. This suggests that more must be done to protect UK start-ups, to help them realise their growth aims. Early indicators suggest that one-year survival rates are improving, demonstrating that the Government's recent growth incentives could be bearing fruit.

However, SMEs are crying out for more support from the Government, and for a better understanding of how to achieve growth in the current economic climate.

The majority of small companies face a multitude of barriers – all of which pose a threat to the future success of their businesses. The UK tax system, a lack of bank lending and the cost of running a business are the top three.

Top 10 Barriers To Business Growth

Tax system 44%	Lack of bank lending 38%	Cost of running a business 36%	Too much red tape 36%	Late payments cash flow issues 35%
Rising energy costs 34%	Not enough Government support 34%	Business rates 33%	The burden of regulation 29%	Too much competition 28%

BARRIERS TO GROWTH

In addition to this dichotomy of rising costs and a lack of finance, two thirds (63%) of business leaders admit it is difficult to grow their firm. More than a third (34%) admit it is getting harder, not easier, to grow their company, and almost two thirds (61%) lack confidence in their ability to achieve three-years' consecutive growth.

Around three-quarters (73%) of small business leaders also say the Government must make it easier for SMEs to access the right information and support for growth. While several of the Government's recent incentives to support SMEs are designed to address the top-cited barriers, perhaps this information is not reaching the people who need it the most.

Where to go for advice on how to start a business Click to visit site

Government websites	Federation of Small Business	Institute of Chartered Accountants in England and Wales	The Confederation of British Industry	RSA Broker

Wish List For Achieving Growth

Bank lending 41%	Reduce tax on employment 41%	Reduce business rates 39%	Less red tape 38%	Reduce energy costs 35%
Tax-free investments 32%	Reduce fuel duty 28%	Reduce National Insurance contributions 28%	Help with financial management 23%	Better regional support 22%

UK REGIONS

While the post-recession business economy is looking up, the majority of regions are struggling to recover to pre-2008 business birth rates – except for London and Scotland, thanks to the strength of entrepreneurialism in these areas.

London

In addition to regaining its pre-2008 business birth rate in 2012, London has witnessed its proportion of high-growth enterprises rebound – unlike all other regions in the UK, where performance remains subdued.

Despite this, four fifths (80%) of small business leaders in London and the South East admit that it is difficult to grow their business. Two thirds (64%) describe themselves as ambitious, highlighting their desire to grow, and yet more than two fifths (45%) argue that it is difficult to understand and take advantage of the Government's growth measures and incentives.

Wales

The proportion of high-growth firms in Wales dropped by more than half between 2005 and 2008, and has continued to fall. Yet, these firms are the most ambitious of all, with four fifths (80%) describing themselves as such. Nevertheless, almost a third (30%) believe that it is getting harder, not easier, to grow their business and 15 per cent have flat growth expectations (of 0-3%) for the next three years.

Scotland

While the enterprise birth rate in Scotland (11%, ONS) is higher than in any other UK region except London, Scottish businesses don't hold the same degree of positivity.

According to the opinion research, 35 per cent of small business leaders in Scotland have flat growth expectations for their firm over the next three years.

UK SECTORS

The high proportion of micro enterprises in the UK extends to all industries. However, higher proportions are seen in the education, construction, arts, sports and recreation industries – driven by a high degree of self-employment.

While the outlook for some sectors is more positive than it has been in recent years, in terms of their business survival and growth rates, small businesses in all industries are calling for more support from the Government to help them grow.

Construction

While the economic downturn took its toll on all industries, it was construction that really felt the full force of the recession. Activity collapsed after the financial crisis, constraining demand and weighing down the sector's growth. As a result, newly born enterprises' three-year survival rates fell by 10 percentage points between 2005 and 2009, according to the latest official data.

However, the sector is expected to see its growth environment improve in the coming years, with residential construction in particular expected to pick up substantially in response to skyrocketing demand, through schemes such as Help to Buy.

Retail & Personal Services

Retail and personal services, such as hairdressers, beauty salons and dry cleaners, are the most constrained industries in the UK with small business leaders admitting it is difficult to grow their companies.

An increase in retail vacancies on the high street has been instrumental in this, having a knock-on effect on trade. However, the majority of retailers believe that the biggest barriers to growth can be tackled with greater support and guidance from the Government – to help them manage their costs, increase trade and expand their business.

RE-ENERGISING GROWTH

The study shows an unprecedented need amongst small businesses, for more support from the Government to help them achieve their growth plans.

Having witnessed a positive quarter of growth in Q3 2014, it is time for the Government to take back the reins of the small business economy and offer the right incentives to businesses, and to make them easily accessible. Such changes will re-energise confidence in UK businesses' ability to grow, and should lead to further employment, expansion, increased productivity and a greater economic contribution.

This is not to disregard the incentives that the Government has recently introduced – many of which were outlined in the Queen's speech on 4 June 2014 and entrenched in the Small Business, Enterprise and Employment Bill and the National Insurance Contributions Bill.

According to the Government, the purpose of both bills is to strengthen the economy by supporting small businesses; making it easier to access finance; ensuring that red tape is regularly reviewed (and cut down, where necessary); making it easier for small businesses to expand overseas; and reducing National Insurance payments.

While it is too soon to know the full force of these measures, early indications suggest they have been well received and will make a positive difference. However, as small business leaders have told us, it is their lack of knowledge and understanding of these measures – and the difficultly of accessing them – that can stand in the way of them becoming fully utilised. Addressing this will be vital in sustaining the growth of the economy.

Now that the UK's economic recovery has taken hold and gathered momentum, it is more important than ever to understand the nature of businesses and how they can be best supported to flourish and grow. This is especially important as events such as the Ukraine crisis, UK general election and impending interest rate rise continue to threaten their confidence to expand and invest.

CONCLUSION
Look, Innovate and Listen

The DNA of UK businesses has clearly changed over recent years, but there is still enormous ambition and potential for high-growth. By understanding the lifecycle of a business and how this is changing, the Government can identify where the future growth prospects are and help ambitious start-ups to grow.

Despite the Coalition's recent efforts to support business growth, many small business leaders feel the Government could do more. For example, continued reform of the apprenticeship scheme could help micro firms to grow out of this business size category. More tax relief like the National Insurance holiday could also pay real dividends.

As the Government seeks to improve its business growth package, small businesses must monitor how this can help their business and enter a two-way dialogue with local policy makers and advisers – to ensure they are making the most of what's available and de-risking their business, whatever their growth ambitions.

Similarly, small business advisers, including brokers have a critical role to play in helping their clients to perform at the highest level, especially given their deep knowledge of the individual business and local economic climate.

By giving small firms the confidence and support to reach their ambitions – be it through launching a new service, unlocking investment capital or exporting, for example – and by offering greater clarity on where they can turn to for support, the strength of the UK business stock and GDP growth projections will only increase further.

ABOUT THIS REPORT

The Growing Pains study is based on independent economic analysis of BIS, ONS and NESTA data, and independent opinion research among business owners and senior managers at 160 small businesses with growth ambitions in the UK.

Projections for 2011-14 and 2014-17 are based on Cebr's economic growth forecasts.

Business sizes are defined in accordance with European Commission guidelines on the number of employees: micro (0-9); small (10-49); medium (50-249) and large (250+).

'High-growth' is defined in accordance with OECD and Eurostat guidelines: achieving an average 20 per cent annual growth in employment for three consecutive years. The high-growth 'rate' is the number of those firms as a proportion of all firms with 10+ employees in the base year.

Growing Pains was designed and commissioned by RSA and conducted in 2014 by economists at the Centre of Economics and Business Research (Cebr) and market researchers at Coleman Parkes (opinion research).

ABOUT RSA

With a 300-year heritage, RSA is one of the world's leading multinational quoted insurance groups. RSA has major operations in the UK, Scandinavia, Canada, Ireland, Asia and the Middle East, Latin America and Central and Eastern Europe and has the capability to write business in around 140 countries. Focusing on general insurance, RSA has around 22,000 employees and, in 2013, its net written premiums were £8.7 billion.

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