

The year ahead: a view from Britain's small businesses



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Steve Cooper
Managing Director
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It's an article of faith that we are relying on our small and medium enterprises (SMEs) to drive the economic recovery.

These four million businesses are the single biggest employer in the UK, and throughout the downturn have proven profoundly resilient. The number of start-up businesses has remained stable, even grown at times over recent months. In order to succeed they've made tough decisions in terms of budgets, savings and expenditure, but they've continued to trade, even thrive in tough conditions. Key to this has been an ever present critical review of why people will buy their product or service relative to others and how they can continue to produce their product or service in a commercially viable way.

Without these engines of wealth and growth, it's clear we could not achieve our economic goals, which makes this report by Kingston University one of the most important economic studies into SMEs of the day.

What we are seeing laid out in this report is the blueprint for how businesses plan to deal with the coming few years.

The results are encouraging. Over half of small businesses are expecting to grow their profits in 2011, driving the economic recovery, with SMEs in manufacturing, transport & communication, and financial services sectors set to lead the way. Crucially, this optimism is reflected in employment plans with broad plans to increase numbers.

Many businesses seem to be waiting, their foot poised above the accelerator, for increases in customer demand in order to achieve their goals.

Their plans will evolve with demand, but it's clear that they are ready to play a central part in strengthening and sustaining the recovery.

Steve Cooper
Managing Director, Barclays Business

Authors

The Small Business Research Centre (SBRC) at Kingston University is one of the longest established research groups in the UK in the field of small business and entrepreneurship, consistently producing research of a high quality and relevance. Established in 1987, over the last 20 years, the SBRC has developed a growing international reputation for its work, based on an extensive portfolio of research and consultancy related to small business and entrepreneurship, both in the UK and overseas.

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1. Executive summary

- 1.1 Small and Medium sized Enterprises (SMEs)¹ provide a substantial contribution to the British economy and society through their employment, sales and innovative activities. Yet the impact of the global financial crisis on the British economy has created new challenges for this sector, posing potential threats to their survival, performance and growth.
- 1.2 Much has already been written about these challenges and threats. Therefore, research conducted by Barclays Business and Kingston University's Small Business Research Centre sought instead to look ahead to next year and investigate the views, ambitions and plans of 1000 small business owner-managers across the UK.
- 1.3 The small business sector has been viewed by successive governments as an engine that underpins the development of the British economy. The coalition government is relying upon small businesses to drive the economic recovery forward, through the creation of new ventures, employment generation and innovation.
- 1.4 Overall, the research findings presented show that this view is not misplaced. Despite the challenges facing SMEs, our research reveals that owner-managers hold a positive outlook for 2011. However, there are differences in the views of owner-managers and performance of SMEs across the sample, with variations between sectors, regions and size of firms.
- 1.5 Despite difficult economic conditions, the research found that employment by SMEs is expected to increase next year with some variation by sector, region and size. SMEs in Central England and South East England expect the largest increases in employment in the coming year, whilst those in the North East and North West expect a decline. Transport & communications sector and the retail trade sector are set to create the most new jobs, whilst hotels, catering & hospitality and agriculture, forestry & fishing are forecasting the greatest decreases. The results also reveal that micro firms are more positive about employment gains in 2011 than larger SMEs.
- 1.6 Given the difficult economic climate, SMEs appear to be increasingly strategic about where they invest their cash. They are seeking to make investments in 2011 that, they believe, will maximise the use of these resources. For example, 43 per cent of firms are planning to increase their investment in marketing to increase sales; whilst 66 per cent are seeking to maintain their investments in innovation; and 24 per cent are planning to increase their spending in product development and innovation. The greatest increases in innovation investment will occur amongst firms in London and the North East. Related to this, the manufacturing and financial services sectors have the largest proportion of firms seeking to increase their investments in innovation in 2011.
- 1.7 Analysts have recently expressed concern over the challenging job market that graduates face, with some sources suggesting that graduate unemployment levels are at their highest in 17 years (BBC, 2010). This survey sought to elicit the views and plans of owner-managers in relation to graduate recruitment in 2011. The findings showed that 61 per cent of owner-managers and over a third of the labour-force (38 per cent) in the surveyed firms held a degree. In looking to the future, 20 per cent of owner-managers said that they would be looking to recruit a new graduate in 2011, either full-time or part-time. Innovative firms are more likely to plan to increase full-time graduate employment next year.
- 1.8 SME owner-managers are concerned about the weak level of demand in the economy for their goods and services but are being pro-active in planning for the survival, development and growth of their businesses. Access to finance is comparatively viewed as a much less significant problem.

¹ BIS defines SMEs as firms that have less than 250 employees. This is the definition used in this report.
<http://www.bis.gov.uk/policies/enterprise-and-business-support/analytical-unit/statistics>

Executive summary

1.9 In general, the evidence suggests a cautious optimism amongst SMEs when looking to the future. Whilst some analysts may argue that this optimism may be tinged with a usual over-inflated positive outlook by SME owner-managers, the results show that there is evidence of real activity behind this view. After all, 54 per cent of businesses are expecting to grow into 2011, and they are increasing their sales and marketing efforts to realise this growth.

1.10 In summary, our analysis suggests that SMEs are able to make a significant contribution to the economy in terms of their employment, sales and innovative activities. Thus, the emphasis by successive governments and the coalition government on the central role of SMEs in the economy is not misplaced. These firms do have the potential to meet the expectations that the government has for them during the recovery.

2. Introduction

SMEs play an important role in the British economy. Currently, they provide 59 per cent of private sector employment and 50 per cent of turnover (BIS, 2010), making them a significant engine for income and employment generation.

Additionally, SMEs have been recognised as sites of innovation, even during challenging economic times (DG Enterprise, 2010). They can act as bridges into work for the unemployed (HM Treasury, 1999) and enable owner-managers to take control of their working lives (Mattis, 2004). They are also seen to be embedded within their geographical region, providing jobs and supporting other enterprises within their localities (Stam, 2007).

The importance of SMEs in the economy has been acknowledged for some time (see Bolton Report, 1971). Successive governments have sought to stimulate their development through numerous initiatives, including reducing barriers to entry, providing financial measures to encourage start-up and development, promoting innovation and supporting high-growth firms (Robson et al., 2009). However, since the financial crisis emerged, the SME sector has been faced with some significant challenges (DG Enterprise, 2010).

Financial crisis

Despite the substantial contribution that SMEs make to the economy, the recent global financial crisis has had a profound impact, in terms of the performance, perceptions and aspirations of owner-managers. Inevitably, many firms have already suffered from reduced market demand, are experiencing cash flow problems, and have lost key suppliers and customers. Given their key contribution to the British economy, the performance of SMEs forms a central component in the recovery of the economy, its speed and outcome.

Providing insight into owner-manager ambitions

This report draws upon the results of a survey conducted amongst SMEs across Great Britain. The findings provide new and timely insights into the views, ambitions and plans of owner-managers for 2011. Specifically, we focus on three broad areas:

1. **Optimism and ambitions of SMEs in the coming year** – How do SMEs expect their markets to change? What are their expectations of profits? What strategies will be used to combat the challenges of the uncertain economic climate and perceived barriers to recovery?
2. **Investing in growth** – What investments will SMEs be making in 2011 to reposition and enhance their businesses, to prepare for the recovery?
3. **Contributions to employment** – How are SMEs planning on managing their talent? Will there be net changes in the employment of, full-time, part-time and graduate workers and what are the characteristics of the companies where these changes are most likely to take place?

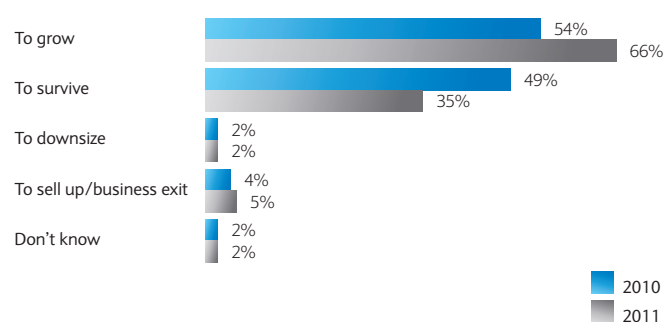
Report methodology

These findings are based on data collected from a sample of 1,000 small and medium sized firms, from a survey conducted in September 2010, covering all sectors, regions and size categories of SMEs in England, Scotland and Wales. A series of statistical techniques have been used to analyse the data which are discussed in more detail in the Appendix. Throughout the report we refer to the respondents as 'owner-managers' for the sake of brevity: these include owners, directors, partners and senior managers who have completed the survey. Of course the survey is a report of surviving businesses and during a recession we do expect higher levels of business churn.

3. Ambition and an optimistic outlook

The results from the survey indicate that the broad outlook of owner-managers is positive, despite the challenging economic climate. Their ambitions for 2011 are optimistic with 66 per cent of firms seeking to grow: an increase of 12 percentage points higher than those seeking to grow in 2010 (Figure 1). This may suggest that owner-managers believe that the recovery will hasten in 2011, but it may also signal that they expect to reap the rewards of actively managing their businesses in the recovery, through investing resources in product and service development and a raised marketing effort.

Figure 1 Ambitions for SMEs 2010 and 2011



Future opportunities

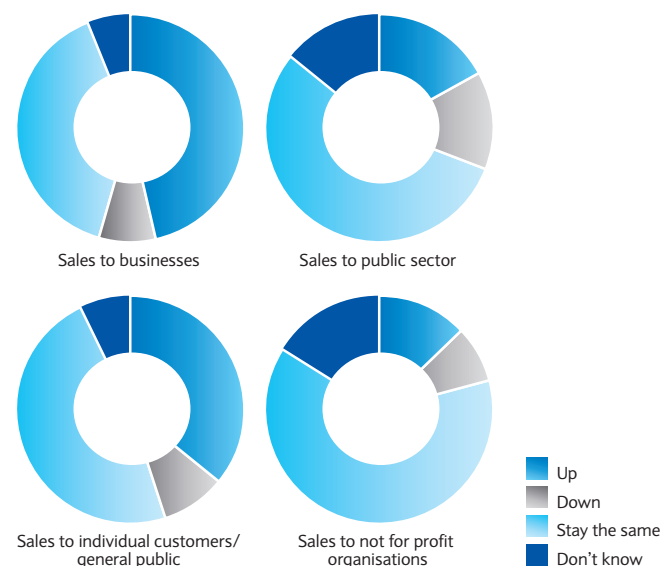
In addition to their own efforts to survive and grow, these SMEs believe that an upturn in the economy will provide the greatest opportunities for growth, as this will create sustained demand for their products and services (46 per cent of respondents). The development of new domestic markets and the introduction of new technology are also viewed by owner-managers as providing new opportunities, diversifying their customer bases and driving efficiency. Some SMEs are expecting to benefit from the demise of their competitors, or their withdrawal from specific markets. This can provide new opportunities for them to pick up on other businesses' misfortunes, or tactical withdrawals from markets, and increase their market share and grow their own business further.

An increase in sales

Overall, owner-managers reported that they expect an increase in sales in 2011 (Figure 2). What is striking about the results is the high levels of optimism when set against a media analysis of 'doom and gloom'. Only 14 per cent of those firms serving the public sector envisaged a reduction in their sales, compared with 17 per cent expecting an increase and 55 per cent staying the same. These numbers have to be taken within the context of the small proportion of direct sales to the public sector (10 per cent) by these SMEs. Historically, SMEs have struggled to obtain government contracts, which will insulate them from government cuts. However, a minority of SMEs that

indirectly supply government departments will experience a reduction in sales.

Figure 2 Expected sales performance 2011



The level of optimism amongst owner-managers varies according to the type of customer base (Figure 2). The businesses included in the survey supply a range of different market types (Figure 3). Most firms are involved in selling to other businesses (47 per cent), followed by private customers (39 per cent) and only around 10 per cent to the public sector:

- Business-to-business sales:** The transport & communications, technology & IT, and manufacturing sectors have the largest numbers of companies that are set to increase their sales. SMEs expecting the largest sales increases to other businesses are also expected to come from London, the South West, and the North East. These businesses may be benefitting from existing links with other established businesses, providing them with access to new opportunities in the recovery. The sectors which have the largest numbers of SMEs that expect their sales to decrease are in construction, financial services, and business & professional services. Given the nature of the recent financial crisis and its links to the mortgage market and financial services and construction, this is unsurprising. Business & professional services may be expecting decreases as other businesses reduce their spending and attempt to fulfil certain functions in-house to trim their expenditure. Regions that will experience the largest sales decreases are expected to come from the North West, Yorkshire & Humberside and Central England.

Ambition and an optimistic outlook

- **Business-to-consumer sales:** The retail trade sector, consumer services and agriculture, forestry & fishing sectors have the largest numbers of firms that are set to increase their sales. The sectors with the highest proportion of SMEs expecting decreases are agriculture, forestry & fishing, construction and the transport & communication sectors. Whilst this may appear contradictory, it suggests that firms in the agriculture, forestry & fishing sector have mixed views, with some expecting sales to increase, whilst others are expecting decreases. This may be due to differences between the firms in the sector. Overall, these sectors may be affected by weakened consumer confidence as uncertainty continues in the recovery. The regions that are expected to see consumer sales increase the most include London, the North East and Scotland. Decreases in business to consumer sales will be found in the North West, Yorkshire & Humberside, the South West and Scotland. The results demonstrate that there are mixed fortunes even amongst firms in the same sectors and regions, most probably reflecting the diversity of products and services within sectors.
- **Business-to-public sector sales:** Given the cut-backs in public sector expenditure, the direct impact on these SMEs may be regarded as muted compared with the impact on larger organisations which are more involved in supplying public sector bodies. However, given that many SMEs supply goods and services to larger firms,

who work with public sector organisations directly, there may be secondary effects that resonate through supply chains, possibly affecting SMEs in the near future. SMEs in business & professional services, hotels, catering & hospitality and construction are expecting decreases in sales to the public sector. On the other hand, some firms are expecting their sales to the public sector to increase. Transport & communications, construction, hotels, catering & hospitality and the agriculture, forestry & fishing sectors, have the highest proportion of SMEs that are expecting to increase their sales to the public sector. The finding that hotels, catering & hospitality as well as construction show the highest levels of increases and decreases in sales to the public sector suggests that there are sub-sector differences.

Firms in London, Wales, and the East of England have the highest proportion of firms expecting to increase their sales to the public sector. The North West, London and Scotland, are the regions that have the largest proportion of SMEs that are expecting decreases in sales to the public sector. Of course, these changes need to be taken in the context of the levels of sales to the public sector as a whole, which across the sample was an average of 10 per cent of all sales. The results again suggest a mixed picture in terms of sales to the public sector.

Case study: Pinesoft Computers

Dr Stephen Dakin established Pinesoft Computers in 1994, to develop computer software and systems for businesses all over the UK. Stephen recently moved the firm to new premises in Central London, with a view to expanding the enterprise and increasing profitability.

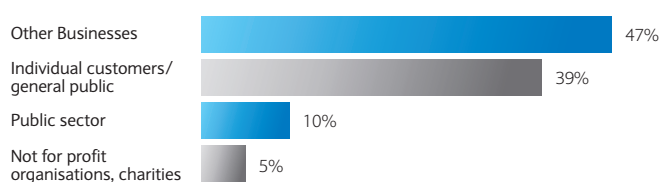
Stephen said: “There is no doubt that it has been a challenging few years for the industry, however our focus on serving a predominantly UK market has meant that we’ve been less exposed to currency fluctuations than similar firms sharing our market.

“We enjoy a solid revenue stream from a handful of large enterprises, for whom we provide complete software solutions for their businesses, and a series of small local business customers, with whom we are able to provide a competitive and good value service.

“Our move to new premises, and its complete refurbishment, has breathed new life into the company and my employees, so we’re feeling optimistic about the future.”

Ambition and an optimistic outlook

Figure 3 Markets of SMEs

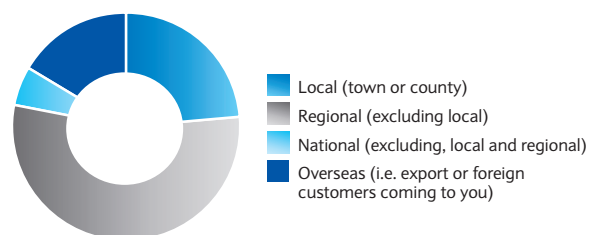


Working harder

A variety of factors are reported by owner-managers as affecting the sales performance of their businesses. The economic climate, market demand, and public sector cuts are evidently pushing sales down. On the other hand, many SMEs were working harder through their own marketing efforts (44 per cent) to counter adverse conditions. This is evidence that owner-managers are not simply weathering the challenging economic climate, but are actively seeking to develop their firms, and seek new and additional sources of business.

SMEs' sales are distributed across their local, regional, national and overseas markets, (Figure 4) and no significant changes are expected in 2011. The focus of their sales is on their regional and national markets, with only a few relying on a growth in exports.

Figure 4 Geographical sales 2010



Changes in profitability

In the latest trading year, almost three quarters (72 per cent) of surveyed firms reported making profit and for 2010, 35 per cent of firms expect profitability to increase. However, they are more optimistic about the prospects of 2011: where over half (56 per cent) of businesses expect their profits to increase.

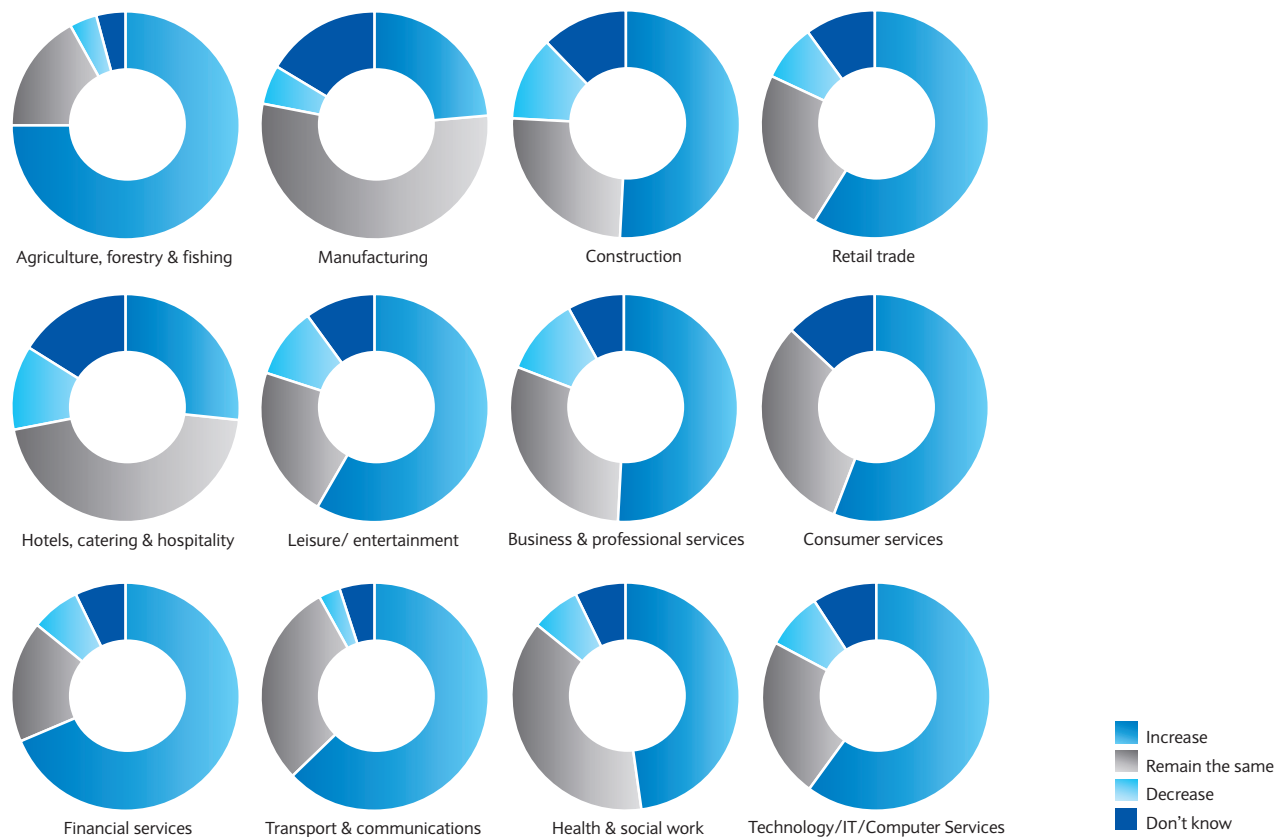
Owner-managers are anticipating that 2011 will provide them with new opportunities and that adjustments to their businesses, including larger marketing campaigns, will deliver additional sales and profits. In doing so, these firms are seeking to expand their markets to drive profitability. In addition, SMEs are innovating and adding to the diversity of their product ranges, to raise efficiency and capture demand in different markets, to drive profits forward.

The sectors with the highest proportion of firms that are expecting profitability to increase in 2011 are agriculture forestry & fishing, financial services and transport & communications. This will reflect increased sales and the introduction of new practices to increase efficiency. On the other hand, the largest expected profit decreases will come from SMEs in construction and the entertainment and leisure sector (Figure 5). This may reflect a weakened housing market, and uncertainty in consumer spending, especially as the full effects of the government cuts are yet to be realised.

The largest proportion of firms expecting their profits to increase in 2011 are in London, Wales and South West England. The regions with the greatest proportions of firms expecting profits to decrease are based in the North West, Yorkshire & Humberside, and Central England. SMEs that are planning on increasing their sales efforts and their marketing in 2011 are also expecting to increase their profits next year, suggesting that these SMEs are not investing to survive, but to obtain growth and profitability.

Ambition and an optimistic outlook

Figure 5 Expectations of profits in 2011



Going digital – growing digital

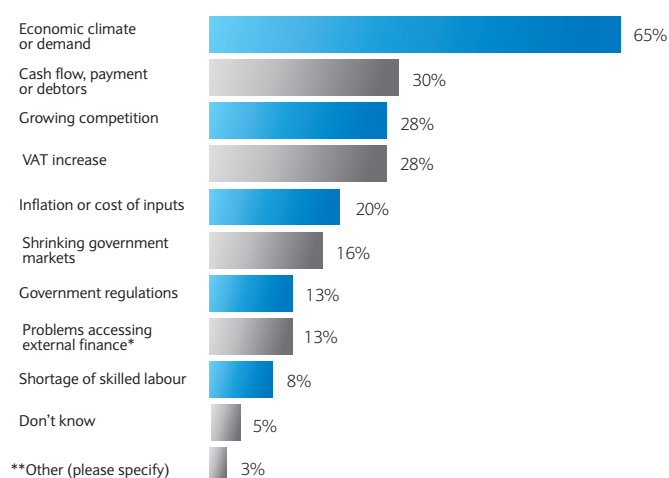
The results suggest that, in 2011, growth will particularly occur in SMEs that utilise web sales. Firms that make sales through their website were also found to be highly likely to recruit full-time employees in 2011. This suggests that these firms are able to grow their business by increasing the geographical range of their markets through online sales to customers, generating the need for more staff to match this growth. Firms which use a website for sales are also more likely to increase part-time workers. This may also suggest a link between the new types of job that website-sales orientated businesses may be generating, and the need for specialist skills to operate web-based platforms.

Barriers to recovery

Within the context of cautious optimism and plans for development, owner-managers were able to identify barriers to recovery (Figure 6). The biggest reported barrier is, unsurprisingly, weak demand linked to the economic climate (65 per cent of respondents). 'Competition for customers' (28 per cent) as others seek to intensify their sales efforts and consumers reduce spending is also a challenge. Another main area of concern for owner-managers is the management of cash flow and debtors (30 per cent), as the delayed payment of goods, through trade credit, can cause substantial cash flow difficulties to SMEs. The increase in VAT is also identified as a barrier to recovery, as is the anticipated increase in the cost of supplies.

Ambition and an optimistic outlook

Figure 6 Barriers to recovery



*e.g. through banks/loan companies

**Other (please specify): Acquiring internet traffic; Closure of businesses that we supply to; Closing company for retirement; Competitors; Customers demanding same or lower prices; Customers not being able to afford to look after their cars; Coalition government; Expanding may leave us a little vulnerable; Fuel costs; Government policies; If the price of oil drops, new work & maintenance drops; Increased Competition; Internet intellectual property theft; Low awareness; Main contractor closing down; My own motivation; My clients are heavily dependent on government funding but my business will continue to grow; Need to relocate business; None x5; Off shoring to India etc; Public sector cuts x2; Reduced demand in the coming recession; Sales; Shrinking outlets and demand; Time x2; Winding down to retirement; Whether customers are employed or not and therefore the amount of disposable money they have.

The barriers to SME development, however, differ somewhat from those often portrayed in the media. Only 13 per cent of firms are concerned about their ability to access external finance from lenders compared, for example, with growing competition (28 per cent).

These results are reinforced when the *single most* important challenge to recovery is considered: 44 per cent said that economic climate and demand was the most important challenge, followed by cash flow (12 per cent) and growing competition (10 per cent); compared with only 3 per cent citing problems of accessing finance. Hence, these results add weight to the argument that there is currently not so much a shortage of finance for SMEs' expansion and development; rather there is probably more of a problem of lack of demand for such funds - deriving from a weakened macro-economic environment.

Subsequently, a recovery in the wider economy is much more important to SMEs than other factors, such as the easing of bank lending. The slow payments through trade credit from customers, pose more of a threat to these firms in recovery, than a shortage of bank lending.

In summary, the responses from those firms that were surveyed indicate that they are seeking to grow, and to enhance their profitability. This suggests that these SMEs are optimistic and stepping up to the challenges of the recovery. Despite a series of challenging barriers experienced by the SMEs in the recovery, expansion into new markets and increases in marketing and sales are viewed as key strategies to overcome adversity in the recovery.

Case study: UVS

Paul Hegedus took over his father's company, Upholstery Vehicle Services (UVS) PLC, in 1998 after 15 years of strong growth. The Manchester based business, which specialises in converting minibuses for use by disabled passengers, sports teams and tradesmen, became a PLC in 2001. Following a record turnover of just under £1 million, Paul is positive about the company's capacity to grow next year.

Paul said, "Despite the recession we've had a very successful year so far. We have a solid customer base and, unlike several other businesses in the area, it's helped us weather the challenging economic climate.

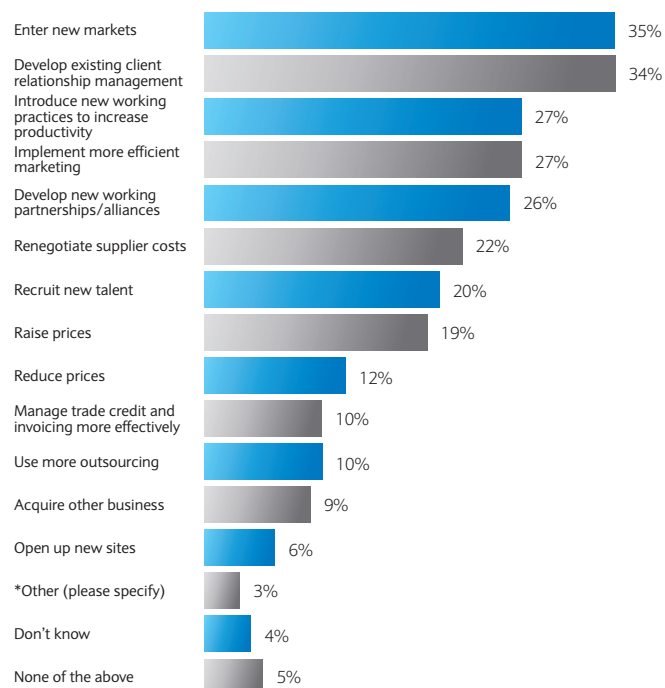
"We currently have eight employees but as our client base is constantly growing across the UK it is very likely that we will be bringing more people in very soon. Our business plan is still to push on and grow, with the increase in staff and the site move. I will be looking at all possible opportunities. It is an exciting time for UVS and we are confident about the year ahead."

4. Investing in future growth?

The research reveals that owner-managers have been actively managing their businesses, to reposition themselves for survival and growth in 2011 (Figure 7). These strategies are far from the alternatives of retrenching, cutting prices and reducing their profits: strategies that are unsustainable and only add further to any downturn in the economy.

Looking towards 2011, SMEs are taking steps towards both consolidating and expanding their businesses. Whilst only 12 per cent of firms claim to be cutting their prices, positive action has been taken to enhance growth: 35 per cent of firms are entering new markets; and 34 per cent are strengthening existing client relationships, to potentially increase sales and improve credit management conditions. Furthermore, 27 per cent of firms are increasing the efficiency of their marketing; 26 per cent are developing new working partnerships; whilst 27 per cent have introduced new working practices to increase productivity, driving profitability.

Figure 7 Strategies for 2011



*Other (please specify): Buy from supermarkets; Cut costs; Diversification x2; Develop new projects; Ensure quality of services provided; Expand; Expansion of the current site and forum; Holding prices below inflation; I plan to exit business x4; Improve website; Improve utilisation; Increased marketing; Keep my price the same as last year; Limit wastage; More company projects; Move into new technology markets; New IT; New skills; Promote Olympic profile; Public relations campaigns to raise awareness of service; Reduce costs x2; Reducing staff; Sell off part of the business; Sell up and let someone younger and more energetic take over and use the businesses full potential; Writing new software products uniquely tailored to customers individual requirements.

Case study: Amici

Mauro Pettinelli has been a restaurateur in Torquay since 1987. A winning combination of food experience, local knowledge and attractive premises means that Mauro has transformed a former steakhouse into a successful and contemporary Italian restaurant; Amici is now celebrating six months of thriving trade.

Mauro said: "Around 70% of restaurants in England belong to a chain but I wanted to offer an alternative, something which I believe is better, where families and holidaymakers can afford not only to eat out on special occasions, such as birthdays and anniversaries but maybe once or twice a month.

"At the height of the season, we have more than 330 holidaymakers and locals enjoy our menu - my aspiration is to offer an enjoyable experience whether customers are just popping in for a morning cappuccino, meeting friends for lunch or having somewhere different to go for a Christmas party. The eatery is open seven days a week and we have a team of 20 staff employed locally, including three managers and six chefs. In the first six months, turnover has far exceeded expectations."

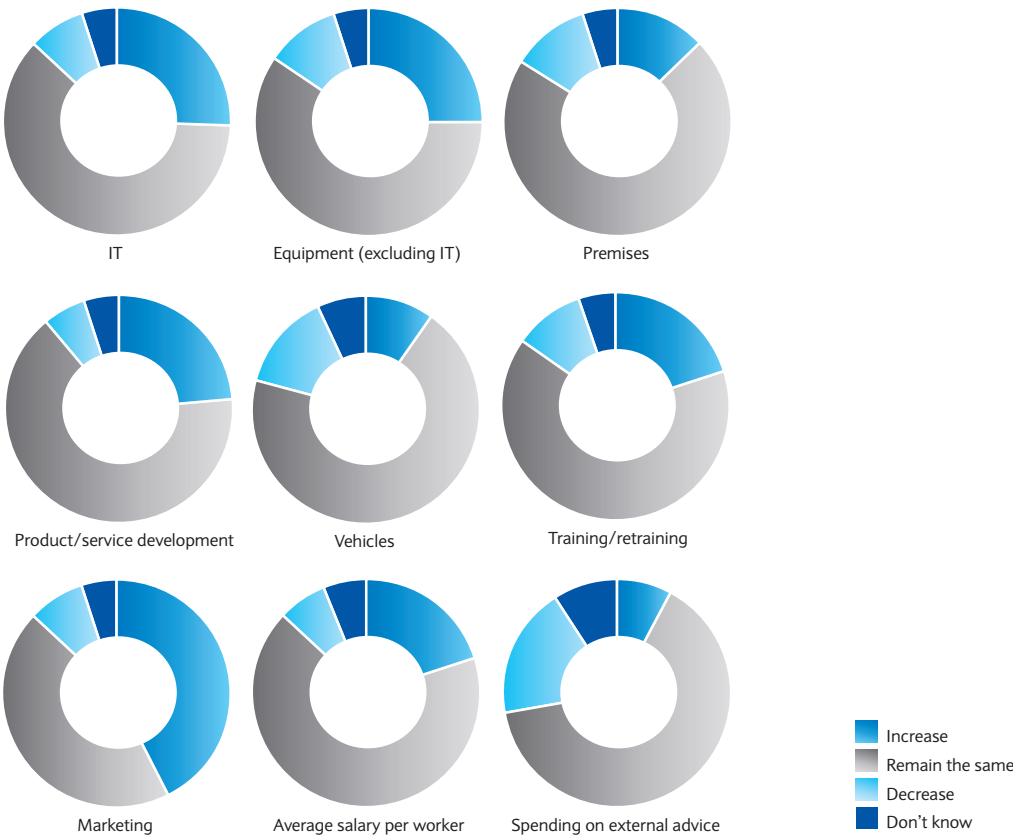
Investing in future growth?

Out of the survey, 35 per cent of firms are seeking to enter new markets, as a response to improving their operations in 2011. This is particularly the case in retail, transport & communications and the IT & technology sectors. This movement into new markets may represent a diversification into different product markets, or the entry to new geographical markets. Both approaches may be assisted further by online sales. New market entry strategies are strong amongst firms in the East of England, and Wales, who are perhaps seeking to move outside of their more ‘traditional’ local markets and escape conditions that are constraining their growth.

Maintaining spending?

Whilst many SME owner-managers talk about growth and consolidation in the future, the question is to what extent is this realistic in terms of them investing in their businesses to help underpin their future aspirations? The research highlights that SMEs are sensitive to the uncertainties of the environment and are seeking to manage their spending and are being selective about where they invest their money (Figure 8). In other words, owner-managers are seeking to accomplish more with less, to assist them in growing out of the recovery.

Figure 8 SME investments



Investing in future growth?

Investment focus

Owner-managers are looking to maintain their investment levels in specific areas of their business (Figure 8). These areas include equipment (67 per cent), premises (71 per cent), vehicles (70 per cent), training (64 per cent) and salaries (67 per cent). This may indicate that due to the small size of these SMEs, they do not have the ability to easily reduce their investments in operational areas such as headcount, equipment and premises - strategies that are more common amongst larger organisations - without having a substantial impact on their businesses.

For external advice, although 65 per cent of the surveyed firms will be maintaining their spending in 2011, almost 19 per cent of firms will be reducing spending on external advice. This may indicate that there will be a greater demand for cheaper or free business advice in 2011, as firms seek to stabilise spending. This raises questions as to the quality of free advice sources, where banks may provide a key role in assisting these firms. It is, however, somewhat ironic that during difficult economic times SMEs appear to be reducing the take-up of external advice at a time when they are most under pressure and are facing uncertainties. On the other hand, owner-managers may merely be looking to spend less time on such activity, as they focus more on working in their business and manage the changes necessary within an uncertain economic environment.

Investing in the business, but doing more with less

Moving into 2011, businesses will be seeking growth, and trying to do more with less. Overall, owner-managers are planning on maintaining their spending, as outlined above, but they are also increasing their spending in areas which they think will help to grow the business and enhance profitability.

Sales and marketing are regarded as important elements of owner-managers' business strategies, particularly as this enables them to extend the size of their markets. Based on this, 43 per cent of firms are planning to increase their investment in marketing in order to gain customer awareness. This is viewed by SMEs as a way of increasing profitability, forming a central strategy for the recovery in 2011. Investment in IT is also expected to increase with 26 per cent of firms planning to invest. This may signal a strategic investment to drive efficiency gains within SMEs to enhance the profitability of businesses, moving into 2011. The sectors with the largest proportion of firms that are planning to invest in IT are the financial services, the technology, IT & computer services, and the health & social work. This may reflect the nature of the businesses and attempts to use IT to increase business efficiency and thus profitability. The regions with the largest proportion of firms planning on investing in IT are London, the North East and Scotland. Conversely, decreases in IT investment are planned in the retail sector, and the business & professional services sector, indicating that perhaps, less specialist equipment is needed in these sectors.

Case study: BE Event Hire

BE Event Hire rents furniture for use at events and festivals. As owner-manager Simon Evans explains, they have recently moved to new premises in the hope of growing the business:

"Our profits have grown steadily since my father established the business in 1972, and so far we have managed to weather this recession fairly well. Part of the reason may be because we have recently started using online auctions to sell new and second hand furniture via the internet, opening up new markets further afield.

"In fact, mastering eBay has been one of our most successful innovations and we now have a person dedicated to managing and expanding our online presence. One of our ambitions for the coming year is to revamp our own website.

"We currently employ ten people and have recently moved to larger premises to provide more space, but ultimately enable us to expand and meet demand. Hopefully the move will also help streamline the way we do things, allowing us all to be more innovative."

Investing in future growth?

Increased investment

Overall, SMEs in the survey spent 16 per cent of their income on new product and service development in 2010. The results show that although 66 per cent of owner-managers are planning to maintain their investments in product and service development, nearly a quarter are seeking to increase their spending in this area. This is a positive development, potentially increasing the development of new innovative products and services. It can be argued that SMEs are seeking to add new products and services to their existing portfolio, to diversify their customer bases and to cultivate new revenue streams.

Owner-managers in firms in manufacturing, financial services, the retail trade and technology, IT & computer services, are more likely to be planning to increase their investments in innovation. Against a background of cheap imports, the manufacturing sector is perhaps seeking to create new innovative and competitive products, to increase their profitability. Those in the financial services sector may be seeking to develop new products to offset

their expected decreases in business-to-business sales. The retail sector may be increasing the diversity of their markets to increase sales in the uncertain economy, whilst technology, IT & computer services have historically been a rapidly changing market, where innovation is to be expected.

Reductions in product and service innovation investment in 2011 will be greatest in the health & social work sector, perhaps reflecting an anticipation of particularly hard times ahead and thus managing their expenditure accordingly.

SMEs in London and the North East of England have the largest numbers of firms increasing their investments whilst those in the North West of England have the largest number of firms that are reporting a decrease. This is most probably linked to the varying levels of demand in these regions and the different sector-mix of firms across regions.

5. Identifying opportunities for employment in 2011

The optimism of SMEs in the survey is revealed in owner-managers' expected employment changes in 2011. Taking on people involves a sufficient rise in demand for goods and services at the level of the business over and above what can be absorbed by the existing labour force.

The research reveals that, on average, firms in the survey are expecting to increase their numbers of full-time employees from 33 to 34 people, and their part-time employees from 15 to 16. This growth reflects the optimism of firms towards the business opportunities that 2011 will bring, as increases in orders and sales may require a larger workforce to fulfil them. However, the results also show that this increase varies by business size, across regions and sectors. Subsequently, this overall optimistic picture should be treated with some caution and below explores size, region and sector variations.

SMEs and employment change

Overall, the biggest percentage employment gains are to be found amongst micro enterprises. In contrast, firms with a turnover of £500,001-£1m were planning to reduce their headcount by 7.7 per cent, or four employees (Figure 9). This demonstrates the relative turbulence that a recession has across the SME population. This turbulence also varies according to full-time and part-time status.

Figure 9 Full-time and part-time employment change by turnover size



SMEs and full-time employment

Uncertainty amongst larger SMEs

A business size-analysis of the evidence shows that some volatility in full-time employment will occur amongst larger SMEs. The analysis reveals that larger SMEs are likely to create new, full-time jobs in 2011. It may be that they already have more developed operations and are driven by growth ambitions of their owner-managers. This is not surprising, as the self-employed and micro firms appear to be demonstrating more flexibility within their existing headcounts, and have fewer full-time employees to make redundant without having a significant impact on the operations of their organisation. However, the picture in relation to size of SME and employment change is not clear-cut. Some larger SMEs are also planning to shed full-time jobs suggesting that

they are adjusting to challenges in their markets and / or are seeking efficiency gains (Figure 9).

SMEs and part-time employment

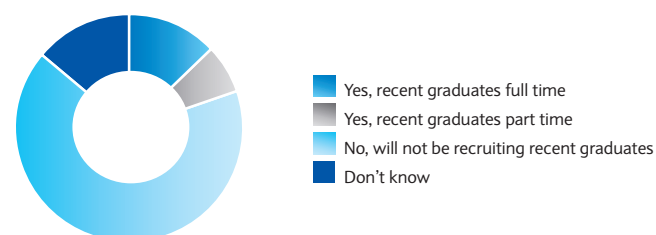
On average, the businesses surveyed employed 15 part-time employees each. The findings reveal an expected increase in part-time employment between 2010 and 2011, an average increase from 15 to 16 part-time staff. Whilst this appears to be a small increase, as with full-time jobs, this increases significantly when the large number of small businesses in the UK is taken into account.

However, the analysis shows that the SMEs that are more likely to increase their numbers of part-time workers are larger businesses. This suggests that larger businesses may be recruiting part-time workers to provide them with flexibility through the recovery and / or are being careful about their recruitment. The analysis finds that those SMEs that are investing in the development of new services and products are also more likely to attract part-time staff, implying that firms investing in innovation may need to increase their headcount to cope with the increased sales from innovations.

SMEs in graduate employment

Despite a negative backdrop of growing unemployment amongst graduates, estimated as high as one in six in February 2010 (Whateley, 2010), many owner-managers surveyed are looking to employ graduates: 20 per cent aim to recruit full or part-time graduates in 2011 (Figure 10). This is not unrealistic: on average 38 per cent of the labour force employed in these SMEs have a degree.

Figure 10 Employment of graduates and anticipated recruitment 2011



Traditionally, graduates have regarded their main career opportunities to lie within blue-chip firms, with their formal training schemes and lucrative salary prospects. In contrast, many graduates have simply not considered SMEs as a route to employment due to limited career progression opportunities and university career planning advice that focuses on larger firms (BowEN, et al, 2004). Some SMEs may simply have organisational structures that create barriers to graduate employment.

Identifying opportunities for employment in 2011

The results show that it is the larger SMEs that are also more likely to employ full-time graduates next year. Businesses that are seeking to recruit full-time graduates next year value higher education, which may be due to the education of their owner-managers, as companies whose directors have degrees are highly likely to employ graduates.

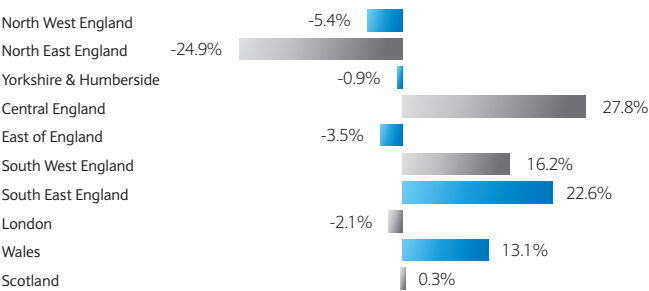
Interestingly, firms that are more innovative and spend more money on developing new products and services are more likely to employ graduates in 2011, perhaps as these new products require specialist skills or knowledge that graduates have. Those that spend upwards of 11 per cent of their income on new products and services are increasingly more likely to recruit graduates in 2011, suggesting a link between higher educational knowledge and its role in innovation. The analysis reveals that no particular sectors are more likely than another to recruit more graduates next year. In short, younger, and larger firms, especially in London whose owners have degrees and are the most innovative are most likely to increase graduate recruitment next year in 2011.

Whilst these findings provide us with insight into the intentions of SMEs next year, and which firms will recruit full-time graduates, they do not tell us about the actual number of graduates to be recruited. However, if 20 per cent of SMEs across Britain recruited just one full-time graduate, this would create 960,000 jobs - more than sufficient employment for all the 674,413 students that graduated in 2009 (HESA, 2010).

A regional view

Overall, five out of 10 regions expect an increase in employment in SMEs and five out of 10 a net decrease (Figure 11), although the absolute changes show a net overall increase.

Figure 11 Employment change by region



Case study: The Carpenters Arms

Seven years ago, professional chef Matthew Hiscox took over failing pub, The Carpenters Arms, in the Welsh village of Coed Y Paen. Since then, the pub has been refurbished, the ever-changing menu has been totally redesigned, and customers – once put off by the pub’s poor reputation – have returned in droves.

Matthew said: “After the redevelopment was complete and we had established a devoted customer base, I decided to take a calculated risk and, in the middle of the recession, took out a loan to build an extension. The gamble has well and truly paid off – customers have been flooding in and I have taken on an extra chef and twenty part-time staff to keep up.

“I am now looking to expand the events side of the business. The pub’s lovely rural setting has made it very popular for wedding receptions, and going in to 2011, I am certain we can further increase bookings.”

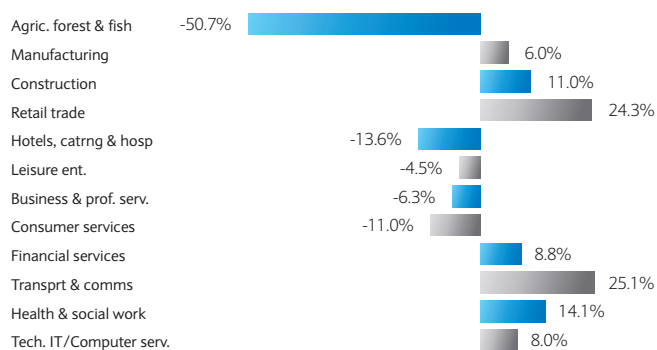
Identifying opportunities for employment in 2011

The largest employment increases in 2011 are forecasted to come from Central England (27.8 per cent), creating 14 jobs for each firm, on average, and the South East (22.6 per cent), nine jobs. Conversely, the largest decreases in employment in 2011, are expected to come from the North East (-24.9 per cent), a loss of nine jobs on average, and the North West (-5.4 per cent), reducing two jobs. This suggests that firms in these regions are seeking to streamline their businesses, or are less optimistic about an upturn in 2011.

A sector view

Overall, owner-managers in seven broad industry sectors expect an increase in employment in 2011 and five a decrease. The sectors that are projected to increase employment the most are the transport and communications sector (25 per cent) with 17 jobs and the retail trade (24.3 per cent), eight jobs per firm on average, suggesting that they are expecting increases in sales and demand (Figure 12). In contrast, the sectors expecting to decrease their headcount the most are the hotels, catering & hospitality sector (-13.6 per cent), a reduction of six jobs on average and the agriculture, forestry & fishing sector (-50.7 per cent), a loss of 22 jobs. These sectors are also more likely to be shedding part-time employees, which suggest that the sector may be expecting a weak recovery, as consumers remain uncertain about the recovery of the economy.

Figure 12 Employment change by sector



Case study: Surestop

In just over three years, Alan Vurlan and his business partner took Birmingham based Surestop out of administration and transformed it into a successful business.

It is now the UK's leading company behind a revolutionary safety mini-switch, conveniently placed in the home and linked directly to the water supply. Alan hopes to continue recruiting new staff, to cope with growing demand for the product.

Alan said: "Our product is not only unique in its design but saves time, money and water. It's exciting technology, so we're pleased to say we are very busy at the moment. We are inundated with calls, mainly from plumbers merchants across the country, who particularly like to use it on key projects working in conjunction with social-housing authorities but also for kitchen refurbishments and for elderly and disabled people who have difficulty getting to their water stopcock.

"It's almost impossible to handle this type of demand without a significant number of staff on hand, so we've doubled the number of people we employ since taking over the business. We recently took on two graduates, who are settling in well in the sales department."

6. Measuring up

Will SMEs meet the expectations of government in 2011?

The government has recently highlighted the centrality of the SME sector to the economic recovery in a recent report: ‘A Strategy for Sustainable Growth’ (BIS, 2010a) and emphasised this commitment in the report ‘Backing Small Business’ (BIS, 2010b). The Sustainable Growth report stresses that the economy needs to capitalise upon sectors with existing strengths which include design, creative industries and specialist manufacturing. In particular, it has been made clear that the government expects the economy’s future growth to emerge from a spirit of entrepreneurialism and that new SMEs need to be nurtured, and existing SMEs need to increase their sales, turnover and employment.

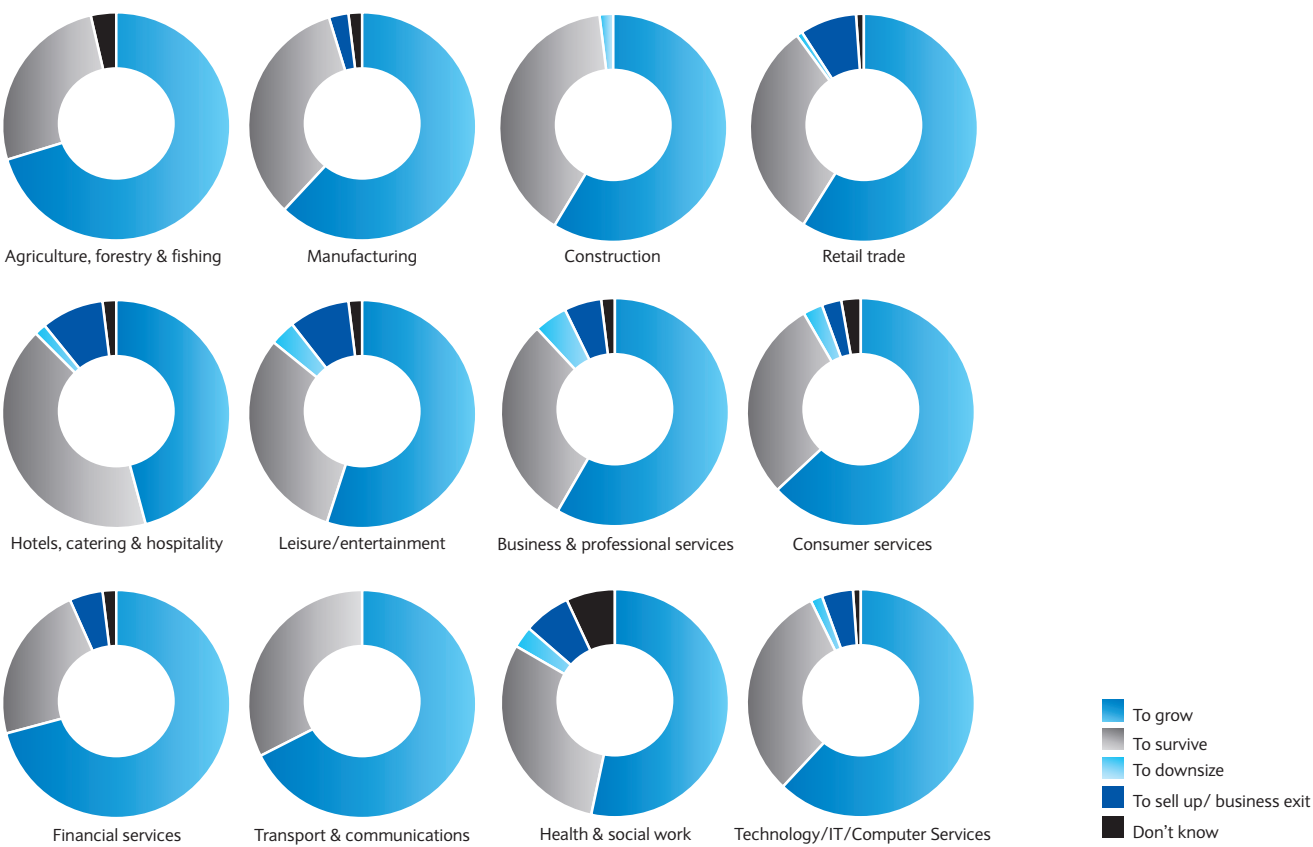
The report on ‘Backing Small Business’ further sets out the government’s plans for enterprise promotion which include the reduction of entry barriers to firms - enabling them to grow. This is based on the government’s aims to target young innovative firms, which have growth

potential and can be nurtured, contributing to the recovery. In the Prime Minister’s speech to the CBI in October 2010 different sectors were identified that could contribute to this growth in the recovery: firms in manufacturing, financial services, IT and retail, as well as the creative industries.

This research focussed on sectors which complement some of the sectors identified in the speech. These include manufacturing, retail, financial services, technology, IT & computer services, and many creative industries, such as gaming, music and film that can be located in the leisure and entertainment sector.

The expectations of growth amongst SMEs, cutting across all the surveyed sectors, are broadly positive for 2011. Figure 13 illustrates that the majority of firms in each sector are expecting to grow.

Figure 13 SME intentions for 2011



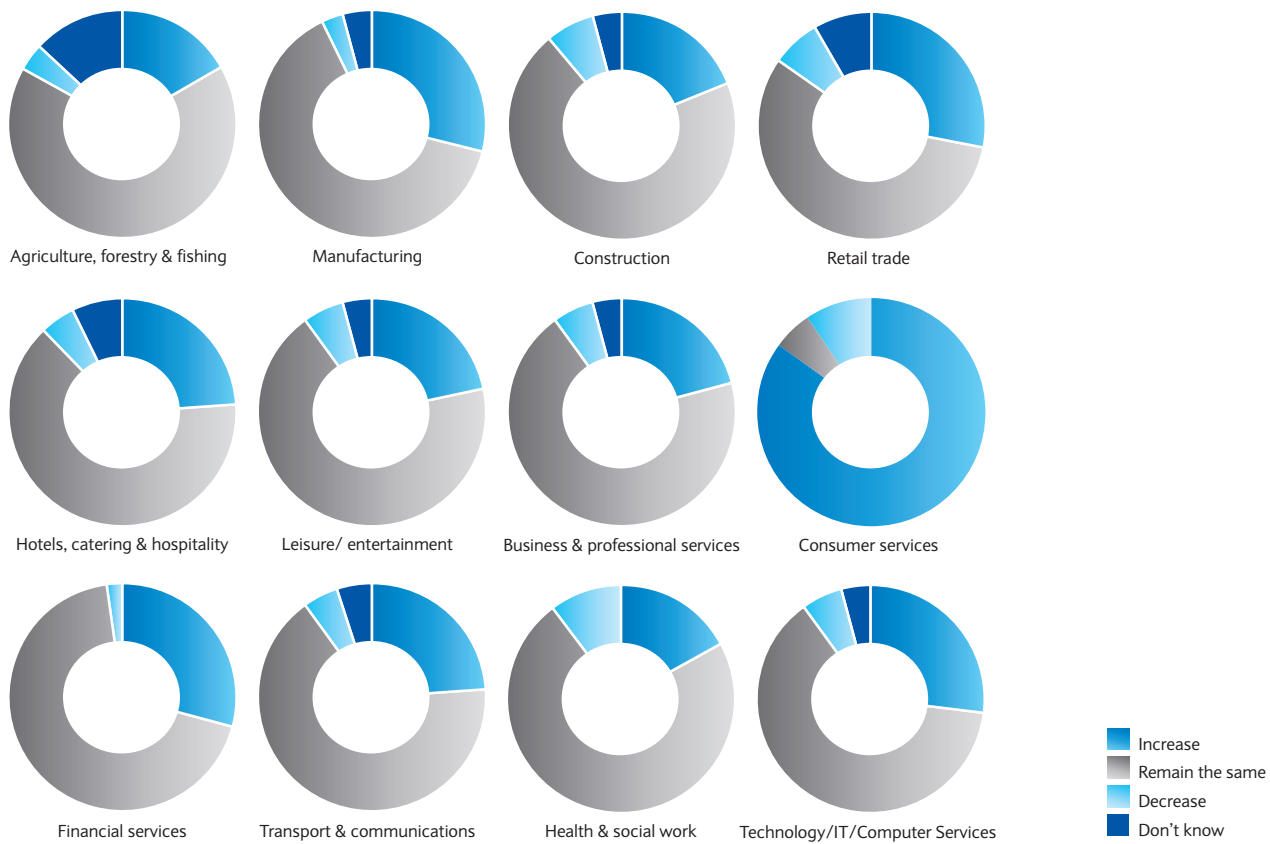
Measuring up

Increases in employment growth can also be used to gauge how SMEs expect their demand to grow, or decline in the coming year, as employee numbers may be increased, or decreased, to meet the varying demand for products and services.

Based on net employment increases between 2010 and 2011, as shown in Figure 12, the firms in the sectors from this survey will be growing in line with government expectations. Net employment increases will be highest in the retail, financial services, technology, IT & computer services, and manufacturing. Growth is also expected to come from the social care and construction sectors. However, based on the net employment changes in 2011, the leisure & entertainment sector, consisting of many creative industries, is set to decrease employment in 2011; perhaps as these consumer facing businesses expect a decrease in spending.

The findings from the survey suggest that investments in innovation across these sectors are also set to improve, with at least 20 per cent of these firms in each sector seeking an increase in 2011, as shown in Figure 14. This indicates that products and services which are new to the firms and industry, could emerge from these investments, in the manufacturing, retail, leisure & entertainment, financial services and technology, IT & computer services sectors. Despite the challenges and volatility that are affecting the recovery, the majority of firms across all the sectors surveyed are set to maintain their investments in innovation. This suggests that sectors in addition to those identified by the government could also deliver growth and innovation to the economy in 2011.

Figure 14 Investment outlook for innovation in 2011



In conclusion

This report suggests that the British SME sector is well placed to meet the government's expectations of growth in the recovery. Broadly, SMEs are seeking growth, in all sectors and, with the exception of the leisure & entertainment sectors, firms in the sectors highlighted by the government are expected to increase net employment, whilst innovation is also set to improve.

While these findings are broadly encouraging, it is important to read these findings through a lens that recognises the current fragility of the recovery. Any

implications for public policy from a single study research must be treated with caution, there is one clear message from this research: in order to develop, grow and realise their ambitions, SMEs require an increase in client and consumer confidence to drive demand for their goods and services. Carefully targeted interventions to stimulate SMEs may also be helpful (Mole et al., 2009), although the results do suggest that supply-side measures, such as the need for an easing of finance, are regarded as less important by owner-managers than demand-side factors in securing future growth.

7. Appendix

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Methodology

The findings of this report are based on the analysis of a survey that was completed in September 2010 by Vanson Bourne on behalf of Barclays Business. In total, 1000 SMEs were surveyed across, London, South East England, Central England, East England, North West England, South West England, Yorkshire & Humberside, Wales, Scotland and North East England. These firms had turnovers of under £5 million, and operated in the following sectors: agriculture, forestry & fishing; manufacturing; construction; retail trade; hotels catering & hospitality; leisure & entertainment; business & professional services; consumer services; financial services; transport and communications; health & social work; and technology, IT & computer services.

The data analysis utilises descriptive statistics from cross-tabulations of the data. The data was also analysed using logistic regression models to identify the characteristics of firms that will be statistically likely to be involved in altering employment numbers in 2011.

