The scale of the opportunity: How growing firms can contribute to the UK economy

BRIEFING PAPER

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By John Asthana Gibson, Researcher

This is a follow-up to a previous Social Market Foundation report, sponsored by OakNorth, looking at the barriers preventing 'scale-up' companies from expanding and becoming more productive. Drawing on secure access ONS data, this paper digs deeper into the characteristics of 'scale-ups', and their significant contribution to the British economy, providing fresh evidence to support our recommendations to encourage scale-up growth.

KEY POINTS

- There are significant barriers hindering the growth of scale-up companies, and removing them would boost productivity and economic growth.
- This is because scale-ups make an outsized contribution to the UK economy:
    - They make up just 1% of SME firms, but account for 8% of SME employment and 22% of SME turnover.
    - Nearly 1 million people are employed in scale-up companies.
    - UK scale-ups make a combined turnover of nearly £500 billion.
    - But scale-ups are not evenly distributed across sectors or regions: Scale-ups are concentrated in London – nearly a quarter are based in the capital.
    - One in six scale-ups are in health and social work, with information and communication technology (ICT) also punching above its weight.
- The benefits of encouraging firm growth are huge:
    - Small firms with turnover under £1 million make up the vast majority (91%) of firms, but account for less than a third (30%) of the private sector workforce, whereas companies with turnover between £1m and £100m account for just 8% of firms, but employ 37% of the UK's business employment.

RECOMMENDATIONS

- The Government should implement a range of reforms to improve scale-up growth and spread clusters of high-growth companies more evenly around the country:
    - Establish a cross-governmental Scale-ups Unit, charged with coordinating government policy and improving data on scale-up companies.
    - Identify key sectors to prioritise and identify a geographic hub for each sector.
    - Attract the best global talent by reforming immigration rules.
    - Invest in the UK's skill base.
    - Target financial interventions to support firms in promising clusters.
    - Reform planning to boost business expansion and home buildings.

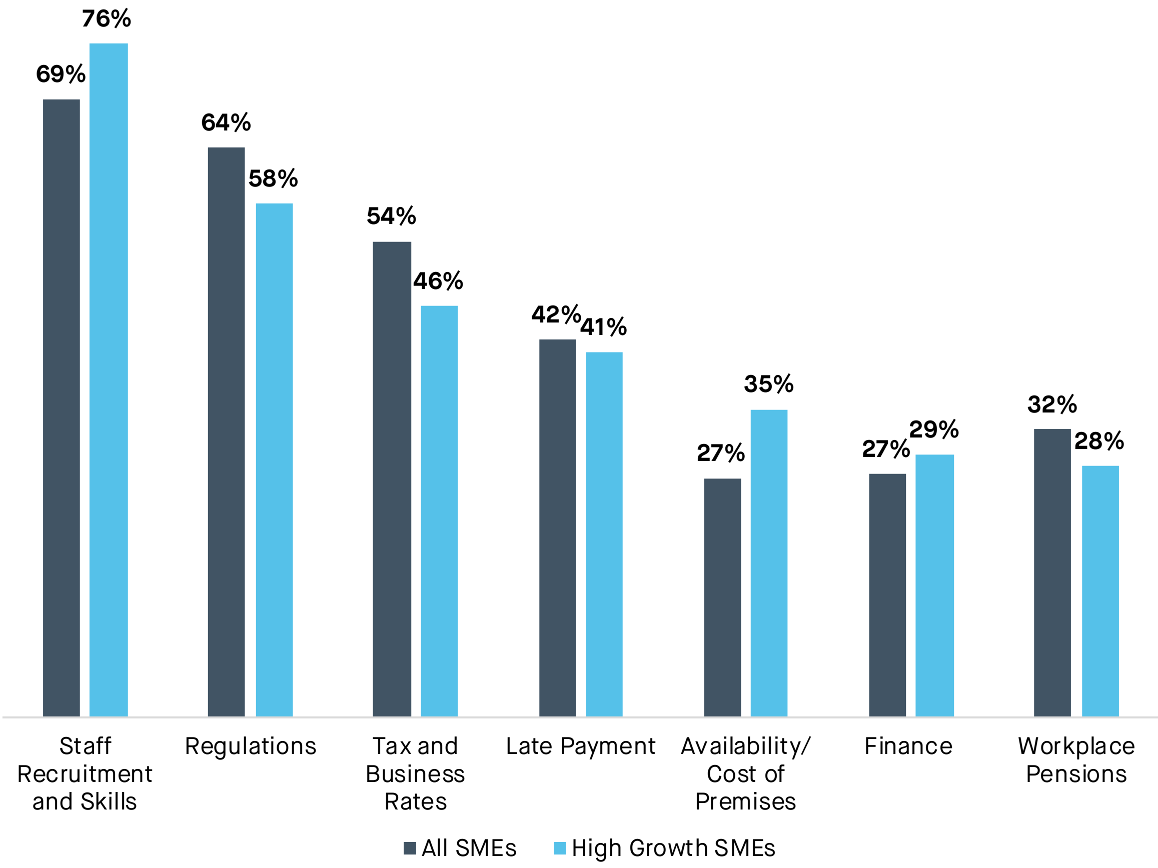
THERE ARE SIGNIFICANT BARRIERS PREVENTING SMALL FIRMS FROM EXPANDING

Despite the economic woes the UK has suffered in recent years, the country has maintained its reputation for incubating ambitious start-up companies. Britain has become a hub for tech firms, of which the fast-growing, from start-and-scale-ups to the most valuable unicorns, raised £24 billion of investment in 2022, more than France (£11.8 billion) and Germany (£9.1 billion) combined.[1] London was ranked second (tied with New York) in Startup Genome's list of the top 30 global start-up ecosystems.[2]

However, whilst effective at getting people to start companies, the UK is considerably less successful at scaling them up to become highly productive and sizeable firms, with the UK's start-up firms failing to realise their potential compared to international peers.

To understand why, the Social Market Foundation recently published *Full Scale*, a report sponsored by OakNorth, that examined the barriers obstructing scale-ups.[3] It concluded that among a range of obstacles, the most salient is access to talent and skills, with the leaders of these companies most frequently reporting this as an impediment to firm expansion (see Figure 1 below).

Figure 1: Percentage of firms reporting issues as barrier to their business success by firm type



Source: Longitudinal Small Business Survey, SMF analysis.

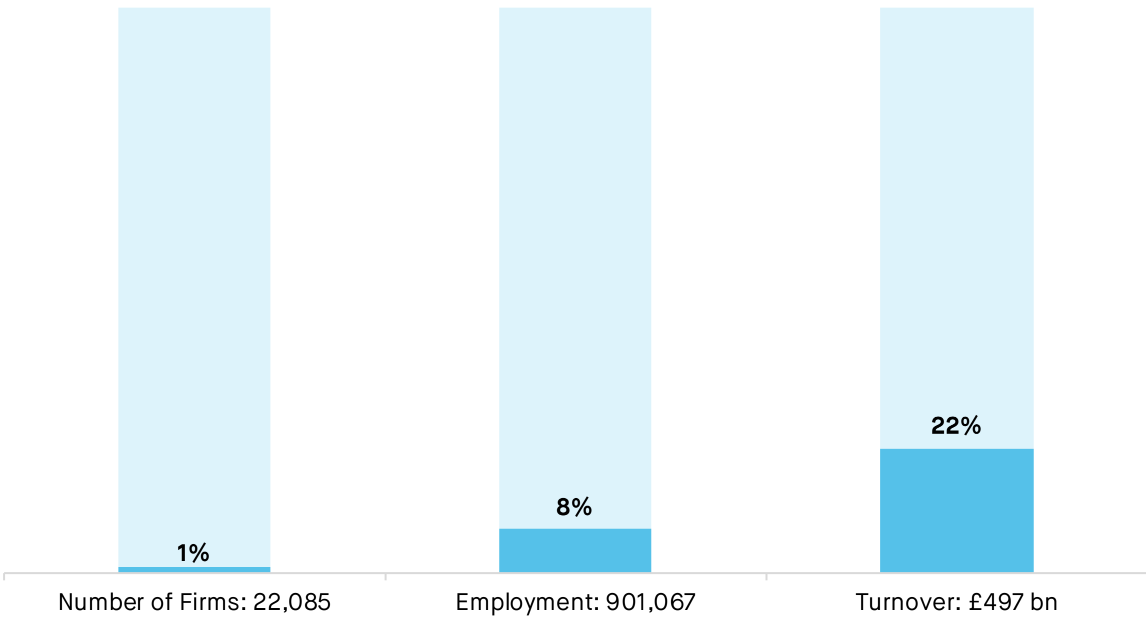
Addressing skills shortages is vital, but not enough on its own. Access to capital, regulations, planning restrictions on development, and developing a more entrepreneurial culture in business management and across society at large are all significant challenges too. Our research and stakeholder engagement found that whilst greater policy attention should be devoted to tackling the issues businesses face in attaining and retaining skilled workers, the panoply of factors curtailing firm growth indicates that no silver bullet can address this problem alone. That report came forward with a number of recommendations, restated in this paper, which would work to reduce the obstacles limiting scale-up growth.

Having examined the barriers preventing high-performing companies from expanding, the purpose of this companion paper is to better understand the sectoral and geographic characteristics of scale-up firms, and to illustrate how tackling barriers limiting scale-up growth is of critical importance to the UK economy. Having a vibrant start-up culture is of little benefit to the wider economy if start-ups fail to grow, or if successful ones choose to relocate elsewhere to expand. Helping businesses with great potential succeed holds the promise of more jobs, increased productivity and higher economic growth.

SCALE-UPS MAKE A SIGNIFICANT CONTRIBUTION TO THE UK'S ECONOMY

In our analysis of high-growth SMEs, defined as those exhibiting average annualised turnover growth greater than 20% per annum over the period 2018 to 2021, we find these firms account for a disproportionate share of jobs and turnover. These scale-up firms made up just 1% of all SME firms, yet accounted for 8% of employment and 22% of turnover from these SMEs (see Figure 2).

Figure 2: Scale-up employment and turnover as a percentage of all SMEs



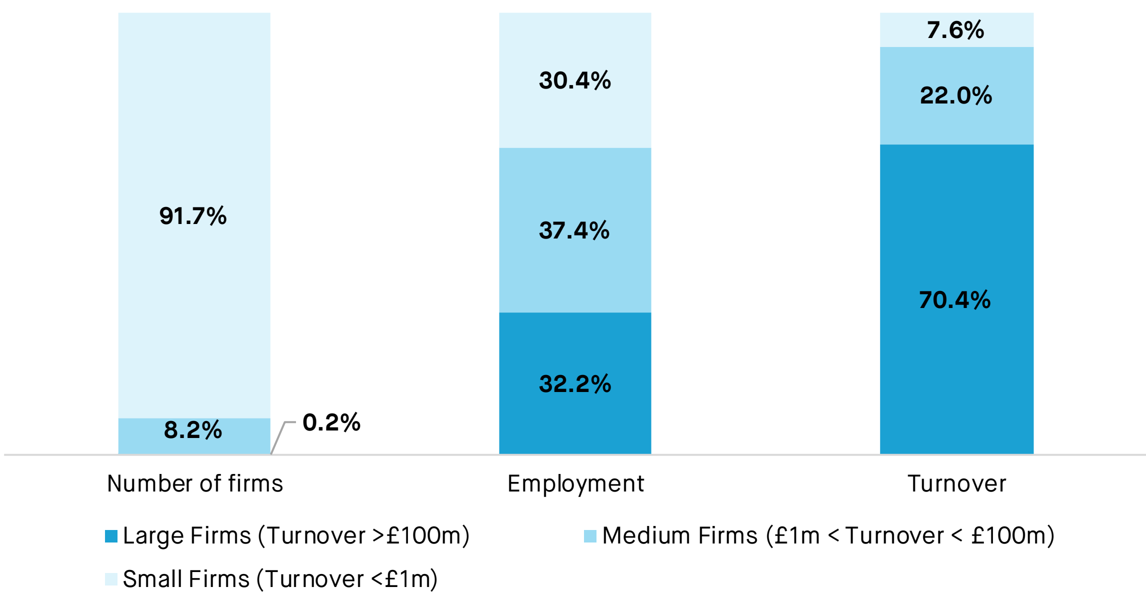
Source: Office for National Statistics, SMF analysis

These figures demonstrate the critical importance of these scale-up firms to the UK economy. Employing over 900,000 people across the UK, these scale-up companies provide generally well-paid jobs. On average, each scale-up employs over seven times as many workers as their non-scale-up SME equivalents. The considerable turnover from this small group of firms accounts for over a fifth of all economic activity by British SMEs. By nature, these scale-up firms are the most innovative and productive companies, whose disruptive activities make the UK a more dynamic economy and improve the quality of goods and services sold in on world markets.

LARGER FIRMS DELIVER A GREATER CONTRIBUTION FOR THE UK ECONOMY

When we take a separate look at businesses by turnover size, we can see how enabling these scale-up firms to grow into large businesses could do a lot of good for the UK economy. For businesses that have an annual turnover of between £1 million and £100 million, average turnover per worker is nearly two and a half times greater than it is in small businesses with less than £1 million turnover (£136,149 versus £58,146). For companies with a turnover of more than £100 million a year, that figure rises to £505,355 per worker, nearly 9 times that from small firms. These figures indicate that as firms get bigger, their workers become more productive and the contribution individual enterprises make grows in turn, reflecting the economies of scale afforded to growing business.[4] The total turnover from firms with turnover of between £1 million and £100 million amounts to an enormous £1.34 trillion, highlighting the value such firms contribute to the UK's economy. Figure 3 illustrates this important role that larger businesses play. Figure 4 describes the distribution of firms with annual turnover between £1m and £100m across the UK's regions, Figure 5 describes that across industrial sectors.

Figure 3: The percentage of total number of firms, employment and turnover from businesses, by size:



Source: Office for National Statistics, SMF analysis

Figure 4: Medium Firms (£1m < Turnover < £100m) employment by region, as a percentage of national medium firm employment

Region	Employment as a percentage of total
London	**19%**
South East	**15%**
North West	**11%**
East	**9%**
West Midlands	**8%**
South West	**8%**
Yorkshire and The Humber	**7%**
East Midlands	**7%**
Scotland	**7%**
Wales	**4%**
North East	**3%**
Northern Ireland	**3%**

Source: Office for National Statistics, SMF analysis

Figure 5: Medium Firms (£1m < Turnover < £100m) employment by sector, as a percentage of national medium firm employment:

Sector	Employment as a percentage of total
Wholesale and retail trade; repair of motor vehicles and motorcycles	**14%**
Human health and social work	**13%**
Manufacturing	**13%**
Administrative and support services	**12%**
Professional, scientific and technical	**10%**
Accommodation and food services	**7%**
Construction	**6%**
Education	**6%**
Information and communication	**5%**
Transport and storage	**4%**
Arts, entertainment and recreation	**3%**
Finance and insurance	**2%**
Real estate activities	**2%**
Other service activities	**2%**

Source: Office for National Statistics, SMF analysis

Unfortunately, this analysis is unable to produce a more granular breakdown of firms than under broad Standard Industrial Classifications (SICs), the way the government classifies business by the type of economic activity in which they are engaged. The vague nature of these classifications is problematic. For example, firms operating in the wholesale and retail trade are counted with those involved in the repair of motor vehicles, meaning firms engaged in vastly different activities are classed as in the same sector.

But even with the more detailed sub-groups of SIC codes, problems with understanding the true activities of businesses in the economy remain. One issue is that as the economy evolves, SIC codes become outdated and may not fully capture new or emerging industries (e.g. fintech, virtual reality, etc.). Furthermore, as there are no penalties for businesses misclassifying themselves, many are inaccurately labelled.[5] These limitations mean that SIC codes do not provide a reliable way for policymakers to know where industrial strengths and capabilities lie. As such, it is important that better data on firms' operations is available so that policy interventions can be shaped to encourage scale-up growth most effectively.

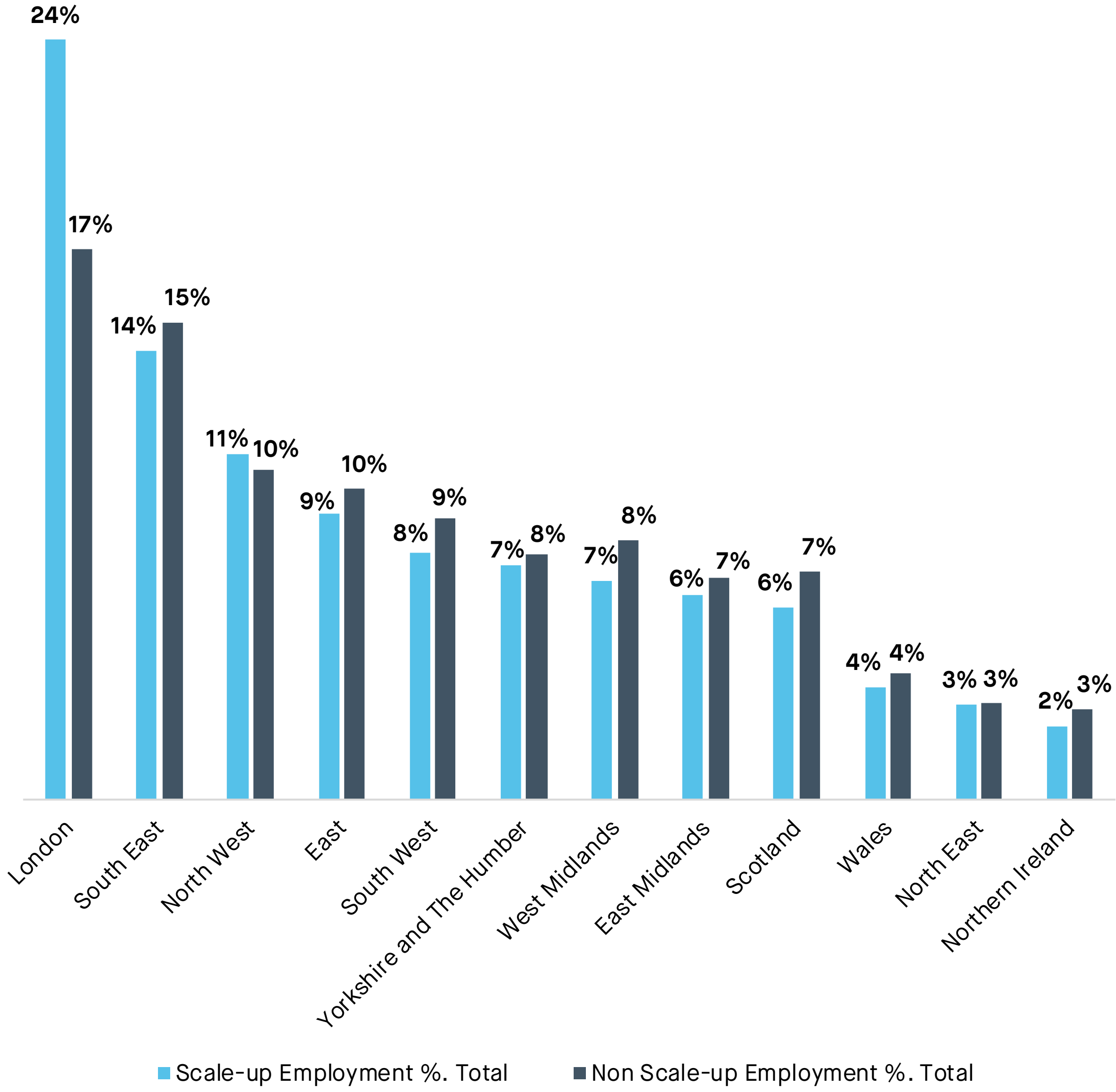
Nonetheless, the outsized contribution scale-up and large firms make demonstrates the importance of lowering the barriers that limit business expansion. Policies that help more firms join the ranks of small but highly successful scale-ups and enabling existing ones to reach their full potential could unlock enormous benefits for the UK economy.

SCALE-UPS ARE CONCENTRATED IN LONDON AND THE GREATER SOUTH EAST

Given their economic significance, it is concerning that scale-up firms are not distributed equally around the country. The spread of UK scale-ups largely mirrors longstanding economic disparities between the UK's regions: they are highly concentrated in and around London. In fact, we find that there are more people employed in scale-up companies in the Greater South East than there are in the rest of England put together.

Figure 6 below shows how, relative to employment from all SMEs, scale-ups are significantly over-represented in London, only slightly over-represented in the North West and under-represented in all other regions. Figure 7 details the number of scale-up jobs per capita exist in each region, with London outshining the rest by a large margin.

Figure 6: Scale up and non-scale-up employment by region, as a percentage of national SME employment



Source: Office for National Statistics, SMF analysis

Figure 7: Scale-up employment per 1000 population, by region

Source: Office for National Statistics, SMF analysis

This distribution of scale-ups is largely to be expected. Scale-up companies are likely to locate in large cities, where they can benefit from access to large numbers of skilled workers and a network of similar companies with which to share information and knowledge. London is a city on a different scale to any other in the UK. In Europe, only Paris competes in terms of population and global significance. It would frankly be surprising – worrying even – if other cities in the UK were able to match the capital for scale-up growth, given its size, resources and skilled labour. There is no reason for politicians to want to level London down.

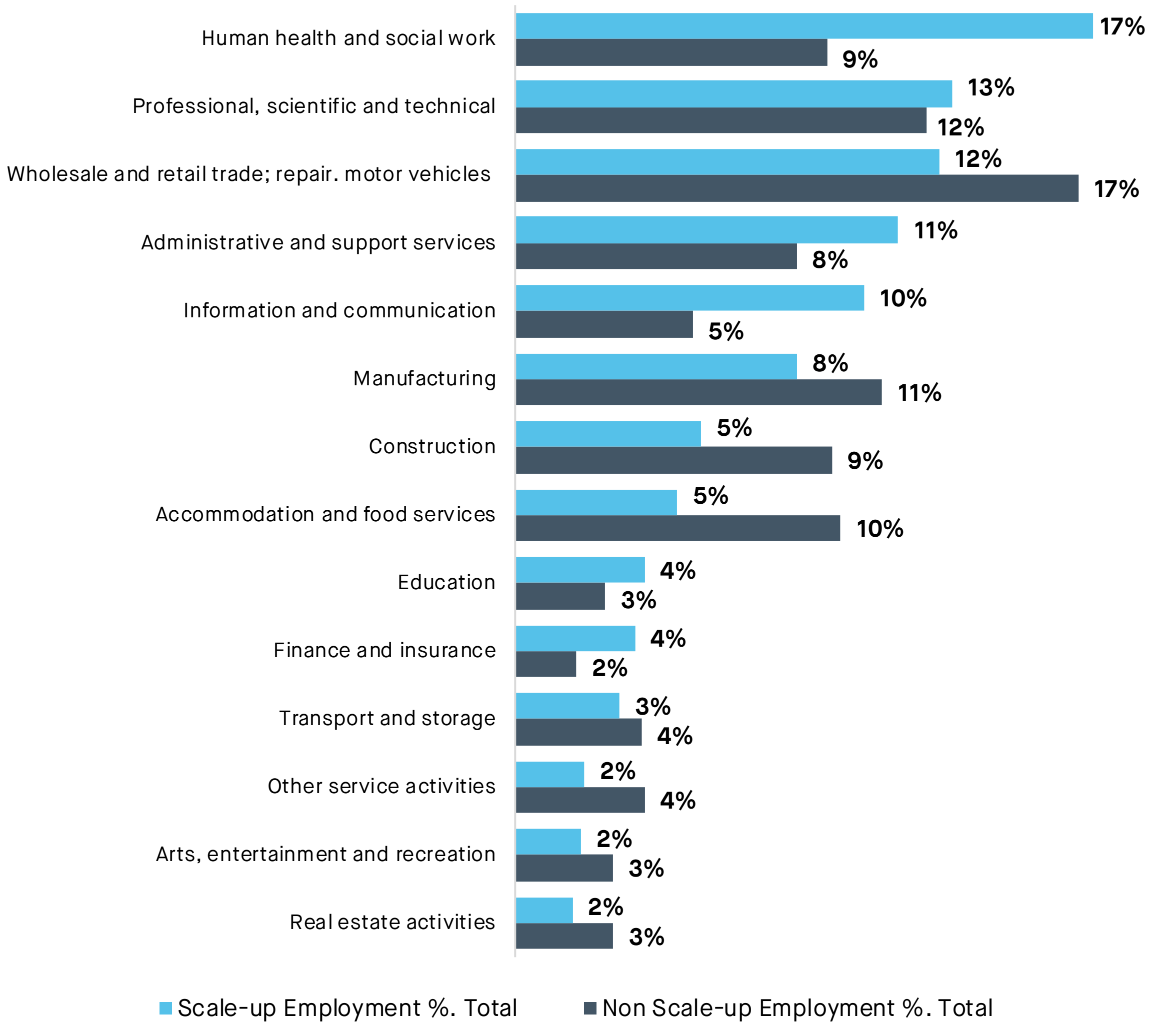
However, whilst London's success is certainly no bad thing, the relative lack of scale-ups in other regions around the country absolutely is. This, too, tracks wider issues in the UK economy. There is a wealth of evidence that suggests the UK's largest cities outside London underperform economically, being less productive than similar sized cities in Western Europe.[6] Research has also shown how a number of the largest British cities, particularly Manchester, Birmingham and Glasgow, have less firms operating in innovative 'new economy' sectors than their size suggests they should have,[7] indicating that these urban areas are failing to generate the benefits of agglomeration that attract innovative scale-up companies to locate where they do. This is a problem for those underperforming areas, who go without the well-paid jobs that these type of firms offer, but also for the country as a whole. More scale-up companies in underperforming areas will drive up productivity and economic growth that will yield benefits across the UK.

To rectify the under-representation of scale-up companies in certain parts of the country, policy attention should be focused on generating more clusters of high growth firms in cities across the UK regions.

SCALE-UPS ARE CONCENTRATED IN SOME BROAD SECTORS

As with geography, the distribution of scale-up companies is not uniform across sectors of the economy. Figure 8 below shows the percentage of total scale-up employment compared with that from non-scale-up SMEs by sector, and highlights how scale-up companies are overrepresented in some industries and underrepresented in others.

Figure 8: Scale-up and non-scale-up employment by sector, as a percentage of national SME employment



Source: Office for National Statistics, SMF Analysis

Around one in six scale-ups is in health and social work, the sector with the greatest share of scale-ups. Professional services, retail, administration, and ICT also contain a reasonably large number of scale-ups. In health and IT, this reflects the higher probability of firms in those sectors making it big, leading to high concentrations of scale-ups. For retail, this merely reflects the sheer size of the sector: there are a lot of retailers and some of them grow quickly. In fact, retailers such as construction and hospitality firms, are less likely to be scale-ups than the wider economy.

Whilst this analysis is unable to provide a more granular breakdown of scale-ups than under broad SICs, it reflects that there are areas where firms in the UK have great capacity for growth, and within those sectors Britain's fast-growing scale-ups are genuinely world-leading. Examples of these high growth industries include life sciences, data science, artificial intelligence and fintech.

These differences are largely explained by the nature of firms' activities, specifically if they are 'exporting' or 'local service sector' businesses. Firms that export goods and services outside their local area and overseas will have a greater potential to grow their order books and scale into large firms, whereas others that sell within their local area (e.g. pubs, hairdressers) will be constrained in their ability to expand. These inherent differences between sectors have considerable implications for government policy. The Government shouldn't expect firms in some industries to become scale-ups, nor should it attempt to encourage that unlikely outcome. Instead, it should focus on the areas where British firms are world-leading and hold comparative advantages over international competitors. These industries, particularly service sectors such as fintech, life sciences, data science, artificial intelligence, therapeutic care and creative/performing arts, are those where the potential of scale-up firms is greatest and growth is most achievable, and government policy should be aimed at developing clusters of such firms in hubs throughout the UK.

CONCLUSION AND RECOMMENDATIONS

From our analysis of high-growth SMEs, or scale-ups, we can draw three main conclusions:

1. Scale-ups generate an outsized contribution to the UK economy and policies that create more such firms and enable their expansion could do a lot of good for the UK economy.
2. Scale-ups are concentrated in and around London – government policy should aim to create clusters of scale-up firms more evenly throughout the country.
3. Scale-ups are concentrated in a few broad sectors – government policy should seek to foster growth in those industries where Britain has a comparative advantage and where firms have the potential to significantly expand.

In light of these findings and the barriers identified in our previous report, we recommend a range of policy measures to help Britain's scale-ups succeed. The government should:

- **Establish a cross-governmental Scale-ups Unit**, with the mission of creating an £50bn in public market cap value from UK growth startups over the next five years by 2028. The unit should be led by the Department for Business and Trade and should facilitate promising businesses to access support and remove frictions, coordinate and evaluate government policies and schemes and direct public money to the most effective interventions – across immigration, health, treasury funding, industry, workplace and pensions, research funding, tax incentives, regulation. However, as illustrated in this report, the limitations of SIC codes curb policymakers' understanding of where British firms excel. Effective policies that encourage scale-up growth need quality data on the activities of companies in the economy. As such, this scale-up unit should also have the responsibility to improve the quality and accessibility of data on, and the monitoring of, scale-up companies.
- **Identify key sectors to prioritise for the UK**, such as green/climate science, fintech, life sciences, data science/AI, therapeutic care services, hospitality/tourism, creative/performing arts. For each of these sectors:

    - Identify a geographic hub for each sector, playing to current strengths while also ensuring that hubs are spread across the country.
    - Attract the best global talent in each of these sectors to these hubs, and facilitate visas for that talent.
    - Invest in the UK's skill base in each hub around the specific sector – scaling up the local universities in each hub, including for adult education, tripling research spending – to create talent density around each sector in each hub.
    - Target financial interventions to support firms in promising clusters – potentially using EIS/SEIS/R&D credit budgets and focusing on equity investment through the British Business Bank.
    - Reform planning nationwide to boost business and homes in each hub.
- Create a more supportive environment and business culture for scale-ups, with a particular focus on reducing bureaucracy and **making public and private sector procurement more favourable**.
- Increase funding for schemes like Be the Business to enhance their capacity to **provide training and mentoring for leaders** of growing companies.
- **Remove barriers to university spin outs** – by standardising agreements with universities – e.g. at 5% university ownership for professor-led spin-outs and 0% for students, with IP kept by start-up companies.
- **Help promote increased ambition in the UK,** by showcasing success stories, and celebrating and mentoring entrepreneurship at schools, colleges and universities.

ENDNOTES

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