Economic Research Paper #7

BOTTLENECKS TO GROWTH

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What is this about?

This note presents analysis of FAME data which highlights growth challenges across Scotland, which is impacting on Scotland's ability to create and grow, more and larger Mid-Sized Businesses (MSBs[1]). Context is provided through comparisons to the rest of the UK.

Why is this important?

Creating more MSBs matters because they disproportionately contribute to growth[6] and are more innovative, more likely to export and more likely to have higher productivity.

However, analysis set out in this paper identifies a series of growth challenges. Growth performance among small (and young) companies in Scotland is strong but achieving and then sustaining growth ultimately becomes less common around the £4m-£5m turnover range, creating bottlenecks.

This weakens Scotland's ability to create more homegrown MSBs as seen by their growth being outpaced by foreign-owned MSBs, as well as MSB growth elsewhere in the UK[2]. It has also contributed to the weakening in Scotland's high-growth firm performance[3].

Five things you need to know

1. Despite the number of Scottish MSBs and their total turnover increasing in recent years, their share of turnover and employment has declined. Scottish MSBs are falling behind with overseas owned MSBs playing an increasingly significant role.
2. High-growth is most common in smaller, younger companies (of less than £4m in turnover).
3. Two growth blockages emerge among £5m-£10m companies which means Scotland has a greater percentage of its growth companies with turnover under £5m compared to rUK, and a lower proportion in every subsequent bracket.
   a) ***Challenge 1 – Achieving one year medium or high growth***. Only 7% of companies in Scotland achieved and sustained any form of 10%+ turnover growth against 26% in rUK.
   b) ***Challenge 2 – Sustaining growth, especially sustained high-growth***. 14% of all growth companies achieved further higher growth compared to 37% in rUK. Only 3% of all £1m-£70m companies in Scotland sustained high-growth, vs 18% in rUK.
4. This suggests Scotland is different from the rUK; despite having a strong entrepreneurial and start-up system there is an inability to sustain high-growth performance.
5. The ultimate consequence of this are fewer Scottish MSBs than achieved elsewhere.

The growth performance of Scotland's economy, including the development of more high-growth firms and mid-sized businesses is held back by the existence of two growth bottlenecks
a) Achieving growth; and then
b) Sustaining growth, and in particular high-growth

[1] There are multiple definitions of MSBs used across research and analysis. In this paper, MSBs are defined as companies with turnover between £25m and £499m.
[2] Mid-Sized Businesses in Scotland 2010-17
[3] Turnbull and Richmond, (2018). Performance of high-growth firms in Scotland

Why do Mid-Sized Businesses matter?

As noted previously, evidence has increasingly emphasised the importance of MSBs to economic growth. SE's Business Plan 2018-19 recognises that Scotland needs more MSBs, which means we need more companies achieving growth and having the ambition to do so.

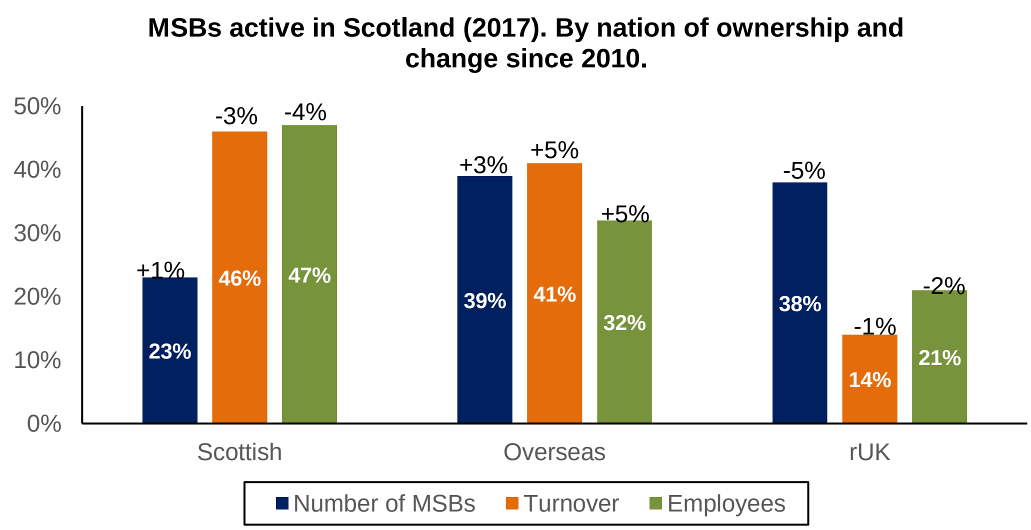
Latest data from the Scottish Government demonstrates the role they play:

Sources: SE analysis of SG data. ONS Labour Market Statistics Dec 2017, Businesses in Scotland (Scottish Government, Nov 2017), Scottish Annual Business Statistics 2015.

Whilst over the longer-term, Scotland's mid-market has grown, the most recent evidence indicates ***the impact of the Scottish-owned MSBs has begun to shrink.***

The structure of Scotland's MSBs

Scottish-owned MSBs make up 23% of the market, accounting for around half of all turnover and employment in Scotland. MSBs are found in every sector of the economy.



Source: SE analysis of SG data

Since 2010 Scottish owned MSBs' share of the overall total has increased, but their share of turnover and employment has declined. Overseas owned MSBs' footprint has increased in every measure indicating that despite an increased market share, Scottish MSB are falling behind and overseas owned MSB play an increasingly significant role.

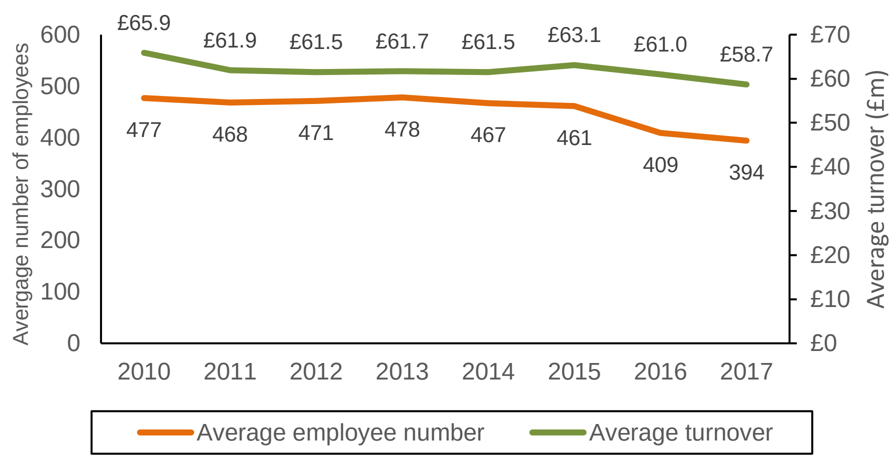
Contribution to change in MSB performance 2010-17, by nation of ownership

% growth in MSBs (2010-17)	Scotland	Overseas	Rest of UK
Total number of MSBs	+17%	+21%	-2%
% of total growth in MSB numbers	+36%	+71%	-7%
Total turnover	+5%	+26%	+2%
% of total MSB turnover growth	+19%	+78%	+3%
Total employment	-3%	+25%	-5%
% of total MSB employment growth	-40%	+173%	-32%

Source: SE analysis of SG data

The average Scottish MSB has declined in both turnover and employee size as the number of Scottish MSBs has increased. This means their overall impact is reducing, and suggests there may be a growth blockage for Scottish companies who grow to £25m+.

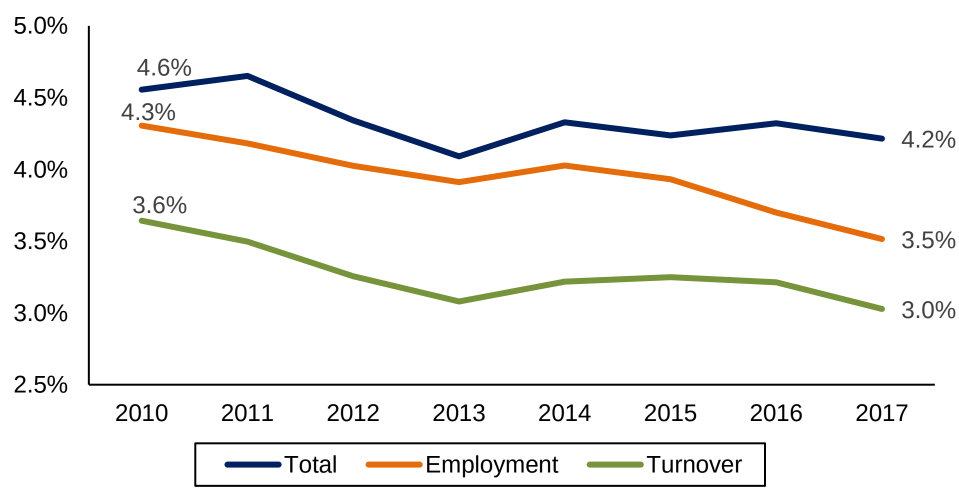
Average Scottish MSB employees and turnover (2010-17)



Source: SE analysis of SG data

The rUK MSB market has also grown considerably between 2010 and 2017, and at a faster rate than their counterparts in Scotland. ***This means that despite growth in the total and the total turnover (but not employment) of Scottish MSBs, their overall impact has fallen behind rUK counterparts.***

Scottish share of MSB performance in the UK 2010-17



Source: SE analysis of SG data

Summary

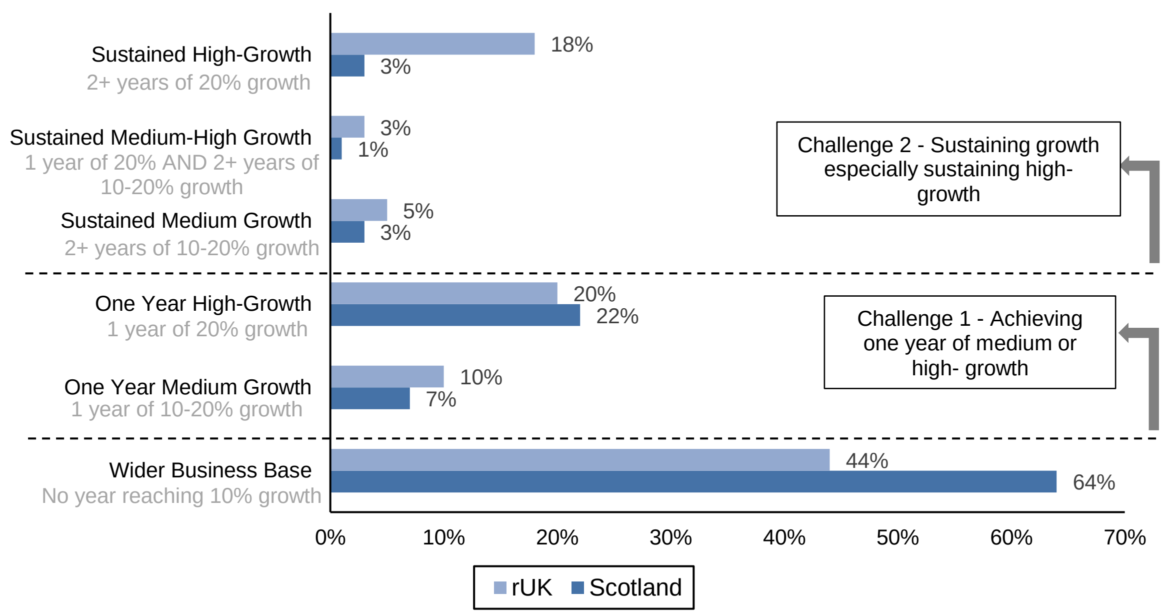
Whilst the total number of Scottish-owned MSBs has grown:

- ***The contribution they make to the total turnover and employment in Scotland is decreasing***
- ***Scotland's MSBs are also performing progressively less well than rUK in share and performance of MSB's***
- ***Overseas owned MSBs are playing an increasingly important role in the economy.***

Why is this?

To understand the underlying factors which have led to this performance of Scottish MSBs, analysis was carried out on companies in the £1m-£70m turnover range as these are the core group of companies supported via Account Management.

£1m-£70m in companies in Scotland and rUK 2011-16 by growth performance



Source: SE analysis of FAME data. Figures have been rounded, and estimates have been excluded

This highlights two principal challenges to maximising the growth of Scottish businesses:

1. creating companies in the wider business base able to grow (defined as 10% turnover growth in one year) and companies able to sustain growth into subsequent years,
2. but particularly high-growth (defined as 20% turnover growth)[4].

These growth blockages emerge among £5m-£10m companies, ultimately leading to fewer MSBs than achieved elsewhere, limiting the economic potential of Scotland.

[4] This was also identified in the *Scale-Up Report on UK Economic Growth* by Sherry Coutu CBE (p.24) which found that whilst the UK has a higher proportion of companies achieving high-growth (20%+ in turnover), the UK has a significantly lower proportion of firms growing at between one and 20 per cent.

Challenge 1 – Achieving one year medium or high growth

In Scotland between 2011-16 only 36% of all companies with turnover between £1m-£70 achieved turnover growth of 10%+ in any single year; the comparative UK figure is 56%.

Scotland has a lower proportion of its business base achieving growth, and this immediately shrinks the pool of potential growth companies to sustain higher-levels of growth.

Challenge 2 – Sustaining growth, especially sustained high-growth

A second fundamental challenge specific to Scotland (compared to rUK) is in sustaining growth, especially sustaining high-growth.

- 14% of all growth companies achieved further higher growth (sustained high-growth and sustained medium-high growth) compared to 37% in rUK.
- Only 3% of all £1m-£70m companies in Scotland achieve sustained high-growth, vs 18% in rUK.
- Only 7% of companies in Scotland achieved and sustained any form of 10%+ turnover growth once compared to 26% in rUK.

Comparison to the rest of the UK

The existence of these two bottlenecks in Scotland appear, from the data analysed to be specific to Scotland. The table below, focused on sustaining high-growth demonstrates this is not a phenomenon replicated in the rest of the UK. Even excluding London (which can often distort UK figures due to its size), Scotland begins to fall behind from the £5m+ turnover bracket onwards.

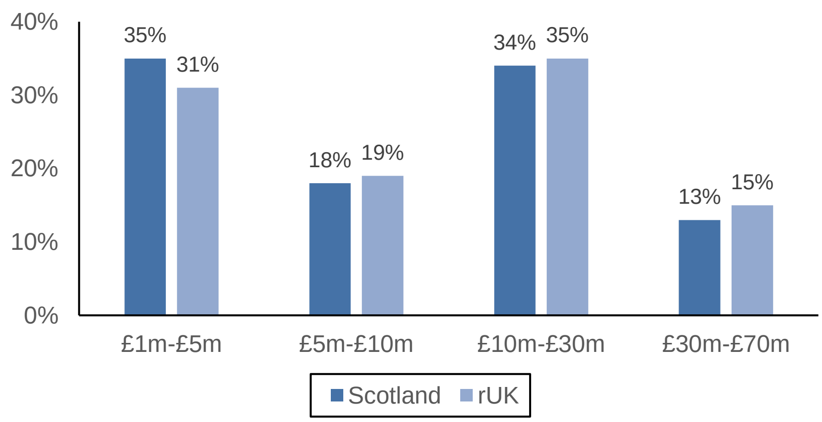
Percentage of all £1m-£70m companies who achieved sustained high-growth of 20% in 2 or more years (2011-2016)

	£1m-£5m	£5m-£10m	£10m-£30m	£30m-£70m	All sizebands (£1m-£70m)
Scotland	4%	3%	5%	7%	3%
rUK	14%	17%	21%	27%	18%
rUK excl London	7%	14%	19%	24%	16%

Source: SE analysis of FAME data. Figures have been rounded, and estimates have been excluded.

The trend towards better early-stage performance in Scotland continues when broadening the scope to any firm achieving high-growth (even just once); The result of these two comparisons is we can say Scotland has a greater percentage of its growth companies with turnover under £5m compared to the rest of the UK, and a lower proportion in every subsequent bracket, creating a deficit in performance compared to the rest of the UK. This suggests a strong entrepreneurial and start-up system but an inability to maintain high-growth performance.

Scotland vs rUK - all companies achieving 20% turnover growth in one year (2011-16) by turnover sizeband.



Source: SE analysis of FAME data. Figures have been rounded, and estimates have been excluded.

Next steps
This research paper forms part of a series, based on research by SE's Economic Research Team.

It is intended to inform colleagues within SE and across partners of the scope, shape and trends in business growth and performance across Scotland and in individual regions, to stimulate a debate about policy priorities and objectives to deliver sustainable and inclusive economic growth.

- This paper will shortly be followed by an update paper looking at business births and deaths and where (relevant to business population) growth has been strongest and weakest.
- Following on from this, data has been sourced from ONS which will provide this by location and sector, allowing further insights into some of the trends in new business creation observed at the Scottish and regional levels.
- New MSB data will update evidence presented in this paper and a more extensive paper covering 2010-17. This will encompass two research papers since sector and geographical breakdowns will be available in addition to the Scotland-wide perspective.
- Finally, analysis is being commissioned to consider Scotland's high-growth firm performance as well as its geographical and sectoral dimensions. Included in this will be further analysis of the trends identified in this paper; that being sustaining growth and high-growth. Again, this will include sector and geographical breakdowns.

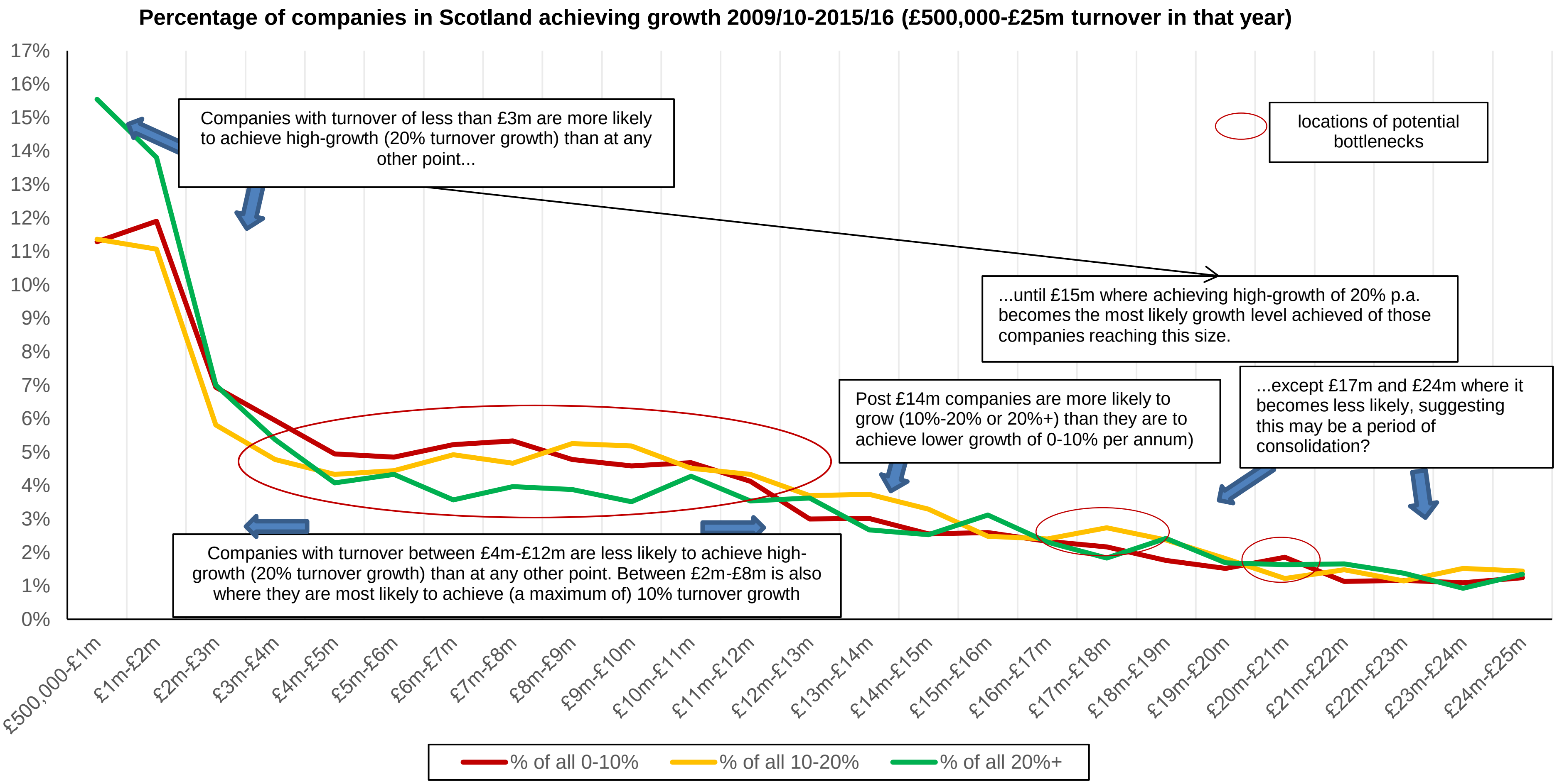
All the above will be sourced the Inter-Departmental Business Register (IDBR) which is managed by the Office for National Statistics. This will enable the merging of the data which informs each of the research papers allowing SE to tell the story of place. Including where bottlenecks are in place, where opportunities exist to encourage discussion and debate, ultimately informing policy support to address and maximise these challenges and opportunities.

Addendum – Further Scotland analysis of growth
Further indicative analysis of the FAME database, looking more widely than the years covered in the analysis earlier in this paper, allows us to specifically identify at what stage in their company journey, growth slows.

Analysing all companies who achieved any level of annual growth once from the start of the financial year in 2009 to the end of 2016, identifies:
- Companies in Scotland are more likely to achieve high-growth at the lower levels of company size and turnover – approximately up to £3m-£4m.
- Once they achieve this mark, companies in Scotland become less likely to achieve high-growth of 20% turnover growth than they are lower levels of turnover growth (0-10% and 10-20% turnover growth).
- Once companies reach approximately £12m in turnover, they become less likely to achieve the lowest level of growth (0-10% turnover growth).
- This largely continues to £25m (the threshold for becoming a MSB).

The evidence corroborates that presented in this paper and is contributing to Scotland's weakening high-growth firm performance[5], and ultimately to the weakening of Scottish MSB performance in comparison to elsewhere[6]. This is why not only business growth, but business creation is vital to Scotland's economic future.

[5] Turnbull and Richmond, (2018). Performance of high-growth firms in Scotland
[6] Mid-Sized Businesses in Scotland 2010-17


Percentage of companies in Scotland achieving growth 2009/10-2015/16 (£500,000-£25m turnover in that year)
17%
16%
15%
14%
13%
12%
11%
10%
9%
8%
7%
6%
5%
4%
3%
2%
1%
0%
Companies with turnover of less than £3m are more likely to achieve high-growth (20% turnover growth) than at any other point...
locations of potential bottlenecks
...until £15m where achieving high-growth of 20% p.a. becomes the most likely growth level achieved of those companies reaching this size.
Post £14m companies are more likely to grow (10%-20% or 20%+) than they are to achieve lower growth of 0-10% per annum)
...except £17m and £24m where it becomes less likely, suggesting this may be a period of consolidation?
Companies with turnover between £4m-£12m are less likely to achieve high-growth (20% turnover growth) than at any other point. Between £2m-£8m is also where they are most likely to achieve (a maximum of) 10% turnover growth
£500,000-£1m
£1m-£2m
£2m-£3m
£3m-£4m
£4m-£5m
£5m-£6m
£6m-£7m
£7m-£8m
£8m-£9m
£9m-£10m
£10m-£11m
£11m-£12m
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£19m-£20m
£20m-£21m
£21m-£22m
£22m-£23m
£23m-£24m
£24m-£25m
% of all 0-10%
% of all 10-20%
% of all 20%+