

# Performance of Scotland's small and medium sized businesses (SME's): insights from the Small Business Survey 2016

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## Abstract

SME employers are a key part of Scotland's economy, accounting for approximately 30% of companies and 40% of employment. This paper provides some insights into the performance of Scottish SMEs, drawing on data from the 2016 Small Business Survey. The data highlights that the proportion of Scottish SMEs that export overseas is lower than the UK average, but the gap is closing. A considerable proportion of non-exporting Scottish SMEs have goods and services suitable for the overseas market, suggesting there is an opportunity to increase exporting rates. Innovation rates amongst Scottish SMEs has declined, similar to UK trends and a declining proportion of SMEs in Scotland are seeking external finance to fund future growth. Finally, Scottish SMEs have lower growth ambition than other parts of the UK, with lower rates of planned training and innovation.

## 1. Introduction

There are just under 105,000 small and medium sized enterprises (employing between 1 and 249 employees) in Scotland<sup>2</sup>. They are an important component of Scotland's economy, accounting for just less than 30% of all enterprises and employing over 885,000 people (42% of all employment).

This paper summarises the evidence on the performance of Scotland's SME employers (i.e. excluding the self employed) from the 2016 UK Government Small Business Survey (SBS)<sup>3</sup>. The analysis considers innovation, internationalisation, investment and factors supporting inclusive growth. Where possible, comparisons with the findings from 2015 survey and with the UK are included.

## 2. Innovation

Innovation is a key driver of productivity and business growth. Businesses that are innovative are more likely to grow and are also more likely to be exporters. Scottish SME innovation performance

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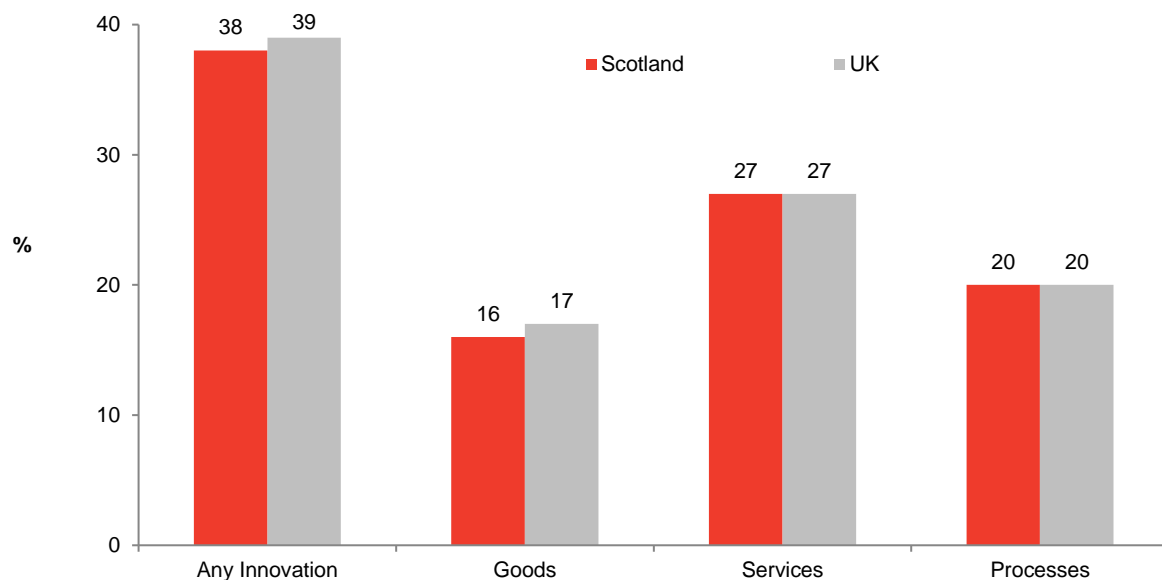
<sup>1</sup> *Scottish Enterprise* is Scotland's main economic development agency.

<sup>2</sup> 2016, *Scottish Government*,

<sup>3</sup> UK Government *Small Business Survey* (2016), *Scottish Government Small Business Survey Scotland* (2016)

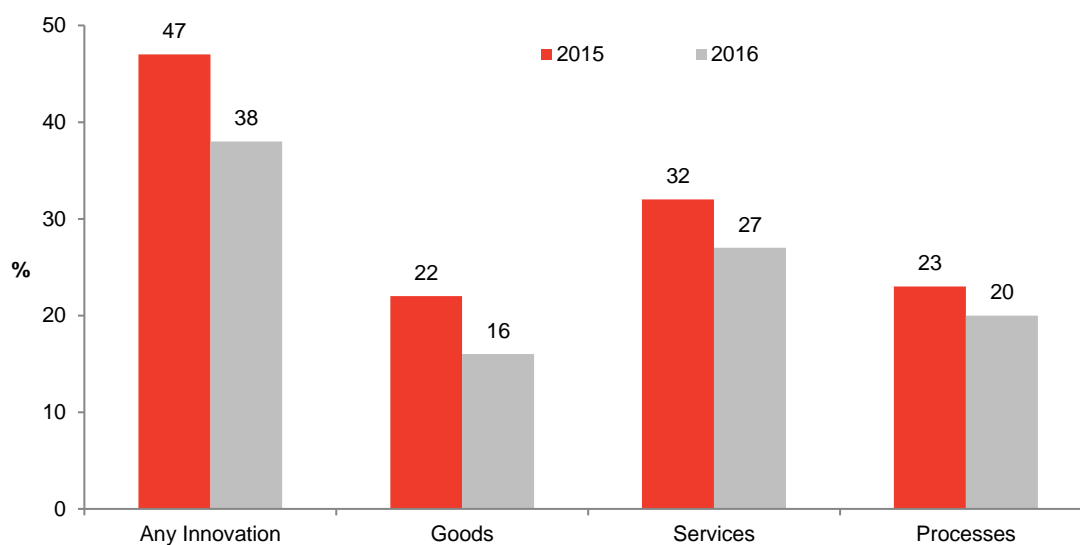
is broadly similar to the UK as a whole but fell sharply in the last year, a trend seen elsewhere in the UK.

**Figure 1:** Percentage of SMEs involved in any innovation in the last 3 years (goods, services or processes), Scotland vs. UK



Source: Small Business Survey

**Figure 2:** Percentage of Scottish SMEs involved in any innovation in the last 3 years (goods, services or processes), Scotland, 2015



Source: Small Business Survey 2016

In 2016, 38% of SMEs in Scotland innovated in some manner in the last three years (whether in goods, services or processes). This proportion was similar to the UK but 9 percentage points less than Scotland's 2015 performance.

Similarly, innovation rates declined in England and Wales (by 11 and 9 percentage points respectively) while Northern Ireland's performance remained unchanged at 40%. It is not clear from the data why innovation rates have fallen in most parts of the UK.

Across the UK, larger SMEs were more likely to have innovated in the last three years, with 55% of SMEs with 50 to 249 employees innovating compared to 37% of those with 1 to 9 employees and 47% of those with 10 to 49 employees. Data for Scotland is not currently available, but the patterns are likely to be similar.

By sector, Scottish SMEs were most likely to have innovated in the information/communication (65% of SMEs), manufacturing (56%), and business services (43%) sectors. SMEs were less likely to have innovated in construction (23%), administrative services (23%) and the primary sector (19%). These are similar to UK figures.

### 3. Internationalisation

Businesses that export tend to have higher productivity than those that don't sell overseas, and exporting can increase productivity levels further. In 2016, 16% of Scottish SMEs (compared to 18% in the UK) were overseas exporters of goods or services, an increase from 12% in 2015. Scotland experienced the highest rise in the percentage of SMEs exporting of any UK country in 2016, driven primarily by an increase in the percentage exporting services. The significantly higher proportion of SMEs in Northern Ireland that are exporters reflects the ease of trade with the Republic of Ireland.

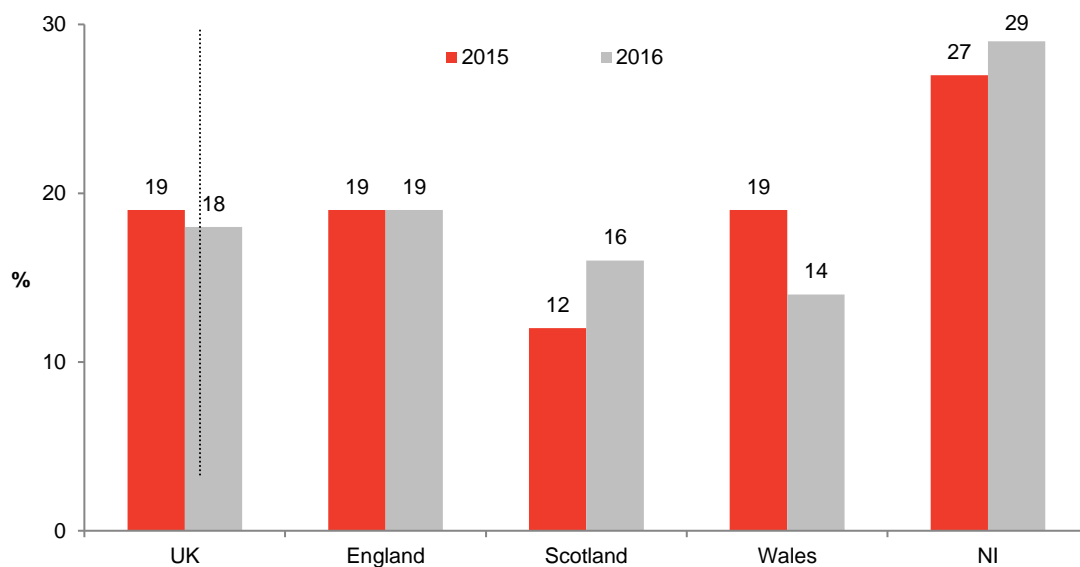
In 2016, 8% of Scottish SMEs (compared to 10% in the UK) were exporters of **goods**, similar to the 2015 figure, while 10% (compared to 11% in the UK) were exporters of **services**, up from 6% in 2015.

Just 4% of Scottish non-exporters plan to start selling overseas in the future (the same proportion as the UK). However, 16% of non-exporters with no future plans to sell overseas reported having goods or services that are suitable for exporting (same as the UK) – this suggests there are approximately 13,500 *potential* SME exporters in Scotland.

Exports are increasingly important to Scottish SMEs as a source of turnover. The share of both goods and service exporting SMEs for whom overseas sales accounted for more than 5% of

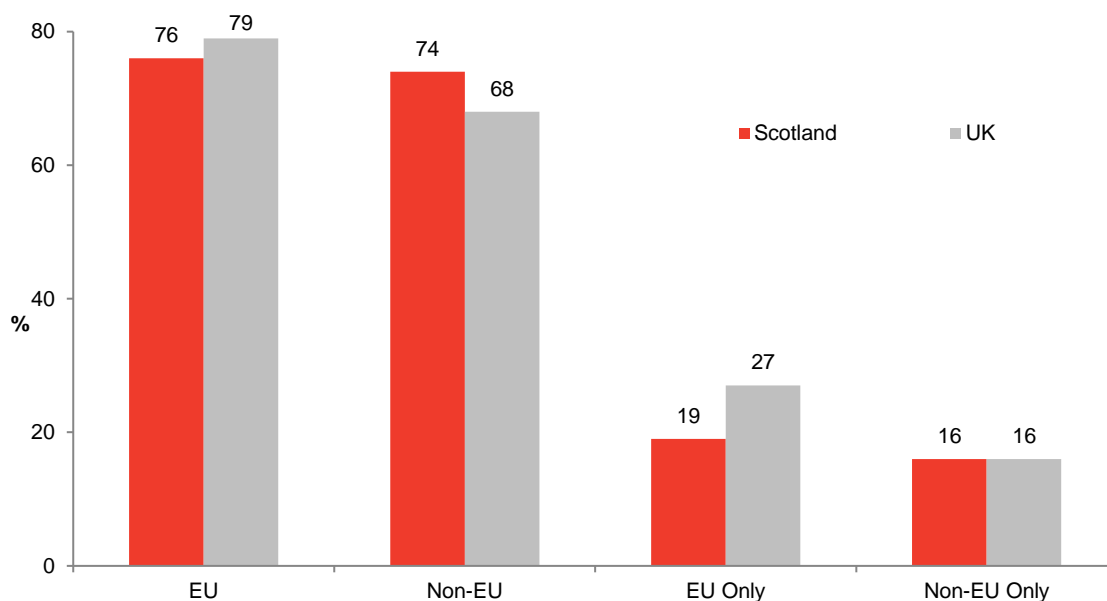
turnover increased in 2016; from 48% in 2015 to 54% for goods exporters, and from 61% to 66% for service exporters.

**Figure 3:** Percentage of SMEs exporting goods or services over last 12 months, UK, 2015 vs.



Source: Small Business Survey 2016

**Figure 4:** Percentage of Scottish SMEs exporting to select markets over last 12 months, Scotland vs. UK, 2016

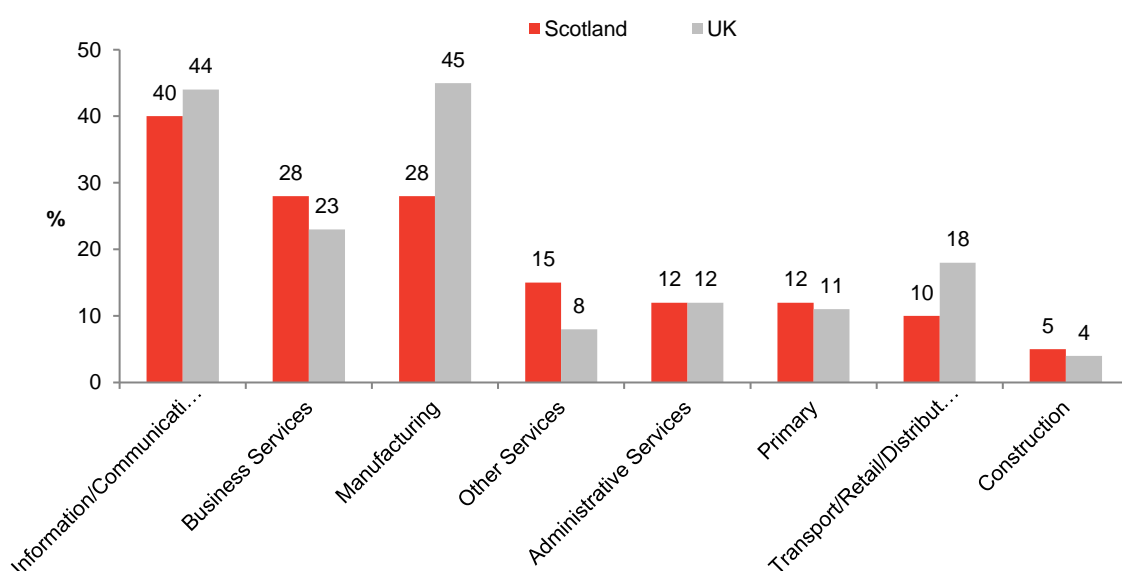


Source: Small Business Survey 2016

SME exporters in Scotland were more likely than the UK average to export to non-EU countries (74% compared to 68%) and less likely to export to the EU only (19% compared to 27%). The proportion of Scottish SME exporters planning to increase exports over the next three years was higher than the UK average (62% vs 57%).

The sectors most likely to be export-active mirror those that are innovation-active – information/communication (40% of SMEs), business services (28%), and manufacturing (28%). It is notable that the proportion of Scottish manufacturing SMEs that export is significantly lower than the UK average.

**Figure 5:** Percentage of Scottish SMEs exporting over last 12 months by sector, Scotland vs. UK, 2016



Source: Small Business Survey 2016

#### 4. Growth finance and investment

A slightly higher than UK average proportion of Scottish SMEs tried to obtain external finance in 2016. Scottish SMEs tend to seek finance for working capital/cash flow rather than for investment purposes. The demand by SMEs for external finance has generally been steadily declining across Scotland and the UK in recent years.

Of Scottish SMEs that sought external finance in 2016, 65% did so for working capital or for cash flow reasons (similar to the UK). 46% of sought external finance for investment purposes (slightly higher than the UK rate), with the percentages of Scottish SMEs seeking finance for traditional investment purposes (construction, equipment, innovation) actually lower than in the UK overall. The total percentage of Scottish SMEs seeking external finance for investment purposes was just

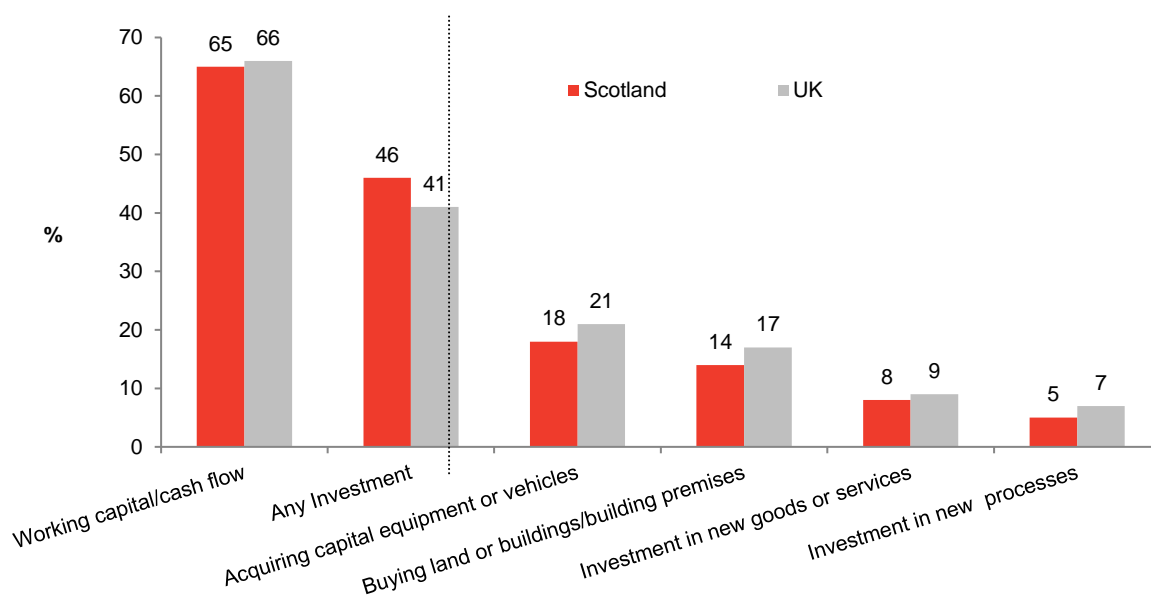
8% of all SMEs overall. Comparisons cannot be made with 2015 because of a change in the way this question was asked.

**Figure 6:** Percentage of SMEs seeking external finance in the last 12 months, UK, 2015 vs. 2016



Source: Small Business Survey 2016

**Figure 7:** Main reasons for seeking external finance in the last 12 months (percentage of Scottish SMEs that sought finance), Scotland vs. UK, 2016



Source: Small Business Survey 2016

The rejection rate for obtaining external finance for those with a known decision was broadly similar in Scotland and the UK as a whole (12% versus 13%). Scottish SMEs on average sought lower levels of external finance than the UK average (with 21% seeking less than £10,000 compared to 14% in the UK). Only 5% of investments did not go ahead in instances where not all of the finance sought was obtained.

A quarter of Scottish SMEs said they would be likely to approach external finance providers in the next three years. Although this was slightly higher than the UK as a whole (23%), it was lower than the rate in 2015 (29%).

Overall this suggests that, increasingly, Scottish SMEs are not looking for external finance to fund future growth, even though they are turning to external finance for working capital. This is a trend that is not unique to Scotland.

## 5. Inclusive growth

Only 3% of SMEs were MEG-led<sup>4</sup> (compared to 5% in the UK, similar to 2015) and only 4% of SMEs had directors and partners from ethnic minority groups (compared to 7% in the UK). This is slightly lower than the proportion of adults from ethnic minority groups in Scotland (5%<sup>5</sup>).

Only 19% of SMEs were women-led<sup>6</sup> (compared to 20% in the UK), although, more positively, 75% of Scottish SMEs had female directors and partners (compared to 71% in the UK).

Workforce development and training is an important element in promoting productivity, fair work and inclusive growth. However, Scottish SMEs (unlike their UK counterparts) undertake less training. In 2016, 54% of Scottish SMEs arranged or funded training or development for staff in the previous 12 months (down from 61% in 2015), 42% offered off-the-job training (down from 47% in 2015) and 43% on-the-job training (down from 48% in 2015). These declines brought training levels in Scotland back into line with UK average levels, which remained constant between 2015 and 2016.

In 2016, 14% of Scottish SMEs (down from 16% in 2015) offered formal apprenticeships in the last 3 years (compared to 17% in the UK) and only 8% of those that did not have apprenticeships expected to have any in the next 12 months (compared to 10% in the UK).

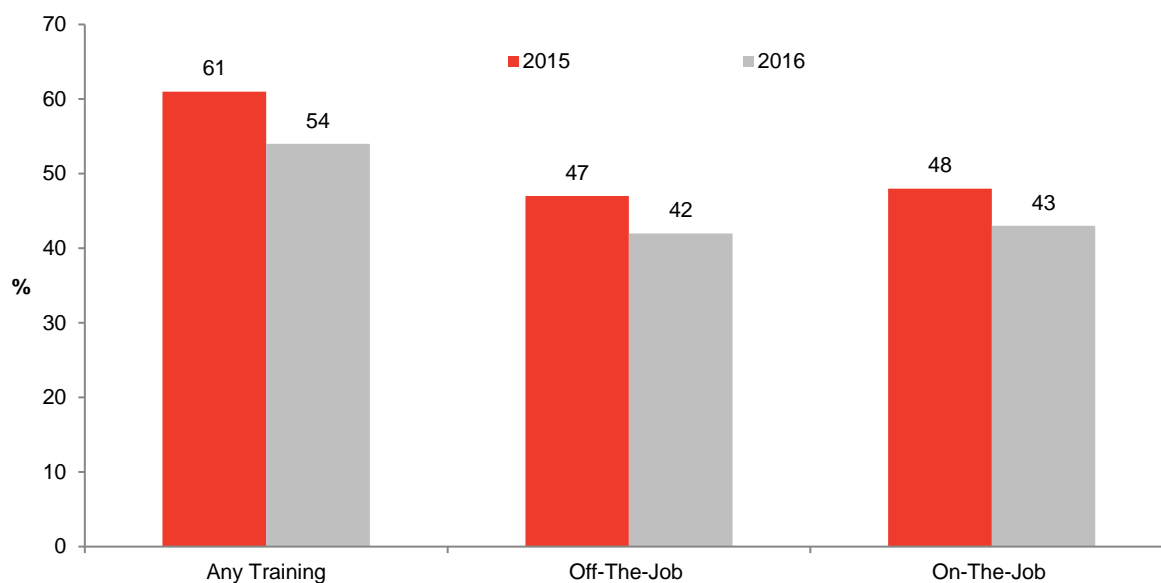
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<sup>4</sup> defined as having a person from an ethnic minority in sole control of the business or having a management team with at least half of its members from an ethnic minority

<sup>5</sup> Annual Population Survey, 2017

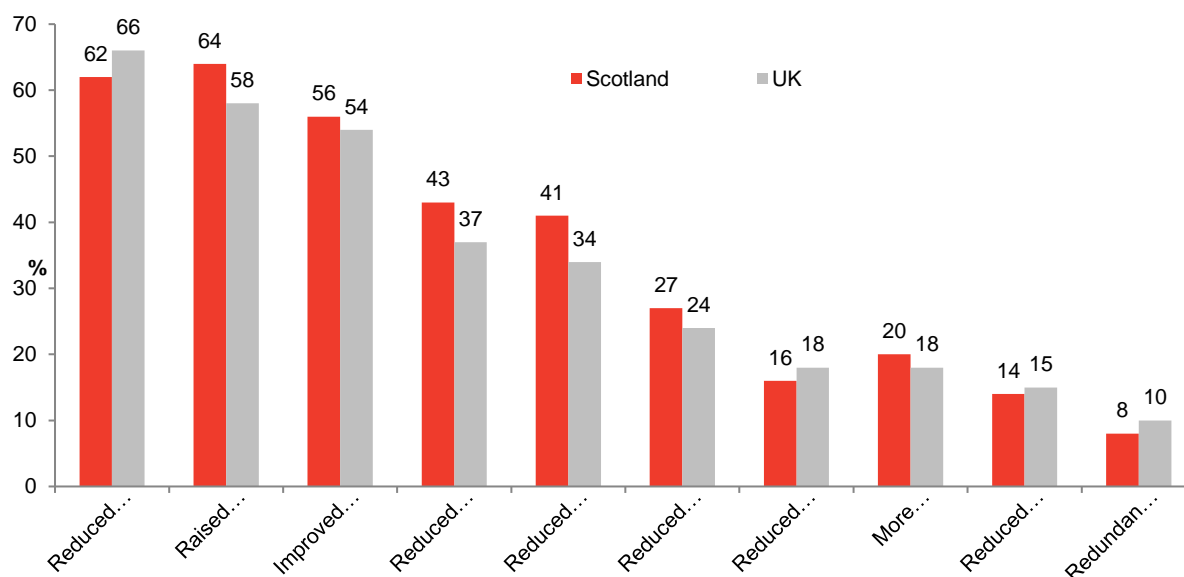
<sup>6</sup> defined as controlled by a single woman or having a management team of which a majority were women

**Figure 8:** Percentage of SMEs arranging or funding training or development for staff in the last 12 months, Scotland, 2015 vs. 2016



Source: Small Business Survey 2016

**Figure 9:** Ways in which additional wage costs have been managed so far (by SMEs already affected by National Living Wage), Scotland vs. UK, 2016



Source: Small Business Survey 2016

The National Living Wage<sup>7</sup> has had only limited effect on Scottish SMEs to date. In 2016, 17% of SMEs (compared to 21% in the UK) have seen an effect on their organisation's wage bill. Of those

<sup>7</sup> introduced in April 2016 at £7.20 per hour



affected, just over half reported increasing productivity as part of managing the additional cost (similar to the UK). If the National Living Wage increases to £9 per hour as planned in April 2020, an additional 27% of Scottish SMEs stated this will raise wage bills (compared to 23% in the UK).

## 6. Other survey findings

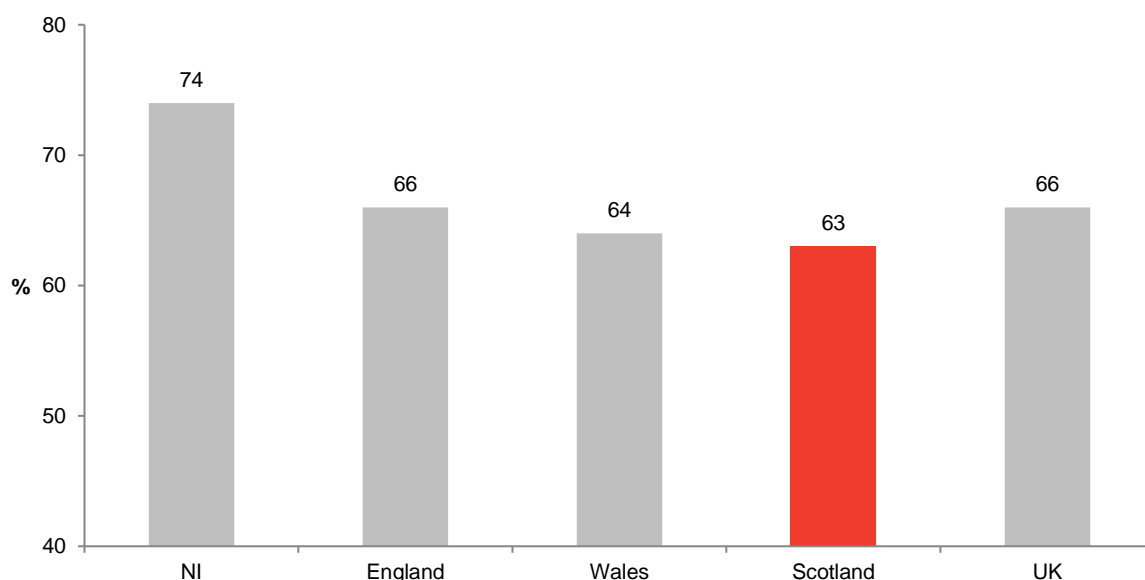
### *Performance & Expectations*

Although not explicitly intended to gauge performance, this year's survey confirms Scottish SMEs experienced a more challenging economic environment than their UK counterparts. In 2016, turnover was more likely to have fallen for a higher proportion of Scotland's SMEs (24%) than in England (20%), Wales (18%), and Northern Ireland (16%).

Considering future optimism, Scotland, with Wales, had the lowest proportion of SMEs who thought turnover would increase over the next 12 months (37% compared to 40% in the UK). Similarly, SMEs in Scotland were more likely than the UK average to think they would employ fewer people in 12 months' time (14% compared to 10% in the UK).

### *Ambition*

**Figure 10:** Percentage of SMEs aiming to grow sales over next 3 years, Scotland vs. UK, 2016



Source: Small Business Survey 2016

Only 63% of Scottish SMEs aim to grow the sales of their businesses over the next three years (the lowest level of all four UK countries). Also, a lower proportion of Scottish SMEs than the UK average plan to engage in activities likely to boost growth:

- staff training: 61% plan to increase the skills of their workforce (compared to 63% in the UK)
- innovation: 33% plan to develop and launch new products or services (compared to 37% in the UK)

More positively, 18% plan to invest in new overseas markets (compared to 17% in the UK).

### ***Use of Business Support***

SMEs in Scotland were more likely to have sought outside information or advice (32%) than those in England (26%), Wales (29%) and Northern Ireland (22%). However, a lower proportion of SMEs in Scotland sought advice in 2016 than in 2015 (37%), and SMEs throughout the UK are increasingly less likely to seek external support and advice.

## **7. Conclusions**

The Small Business Survey provides a useful snapshot of the performance of Scottish SMEs, and how this compares over time and with other parts of the UK. As SMEs account for over 40% of Scotland's employment, understanding their current and future performance is key for the economy overall.

The latest data highlights a number of findings for the key drivers of productivity and business growth:

- Scottish SMEs are less likely to export overseas than the UK average, but encouragingly the gap with UK performance is narrowing.
- There is a significant proportion of non-exporting SMEs that have the potential to be exporters in the future (those stating they have products and service suitable for overseas markets).
- The proportion of Scottish SMEs innovating appears to be declining in Scotland, although the reasons for this are not clear from the survey. This could be an area for future research.
- SMEs tend to seek external finance for working capital rather than for potentially productivity enhancing investment
- Similarly, the proportion of Scottish SMEs investing in staff training and development has declined, and again the reasons are not clear.

The survey also suggests that Scottish SMEs appear to be slightly less ambitious in terms of growth, and in terms of future innovation and staff development activity. This may affect future

productivity performance. The reasons for lower growth ambitions could also be an area for further research.

Overall, the analysis suggests that there a range of areas where SME performance can be improved that would positively impact on the Scottish economy as a whole. These include:

- encouraging more SMEs that have the potential to sell overseas to develop and take forward exporting plans, particularly in the manufacturing sector
- reversing the apparent decline in the proportion of SMEs innovating
- reversing the apparent decline in the proportion of SMEs investing in training and staff development
- encouraging more SMEs to use external funding to invest to enhance productivity.

A range of support and services for SMEs is available in each of these areas, through for example Scotland's Enterprise Agencies, the Business Gateway, employer organisations and other providers. The Scottish Government's review of the Enterprise Agencies has also focused on these issues, with a programme of work underway to further develop and improve the support available to businesses<sup>8</sup>.

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<sup>8</sup> Scottish Government *Enterprise & Skills Review*