Are SMEs responsible for the UK's low productivity levels?

The simple answer is yes, but only partly. The UK is struggling with its productivity levels in comparison to the top three G7 countries; USA, France and Germany. Depending on how you measure it, the UK is somewhere between 10% and 35% worse than the best of these and is fourth overall in the G7. It is often said that the top three produce as much in four days as we do in five. Internationally our position is somewhat lower, again depending on how you measure it, but perhaps around eleventh globally.

Measuring productivity in business isn't easy and it varies greatly from industry to industry. In essence it's the measure of the amount of output relative to the resources input. Typically those industries with high levels of capital investment and high value outputs e.g. oil and gas or tertiary businesses like financial services, insurance and information technology are the most productive whereas industries like hospitality, entertainment and the arts perform badly.

The UK has often been described as a nation of shopkeepers, by which is meant we have a lot of small businesses – around five million at present. There are numerous key factors that can contribute to low levels of productivity, and many SMEs suffer from many of them, they are:

Lack of Funding – is often said to be the single biggest factor in the poor productivity of SMEs. Clearly a lack of funding will also be the cause of poor performance in some of the other factors listed below. In turn, these other factors will often result in businesses being less able to attract external funding.

Low Investment – characterised by low investment in better plant and machinery leading to low levels of automation, poor economies of scale and low productivity. Also, typically a low investment in R&D and IT systems resulting in slow adoption of new technologies and innovation.

Management & Skills Gap – weak and ineffective management practices and leadership skills. Resulting in poor decision making. Failure to adopt best practices and optimise processes resulting in inefficiencies across the business. A low level of investment in training and low wage levels preventing the recruitment of higher skilled management and staff.

Short-termism – lack of long term planning and investment often due to concerns over the future economic situation. Decisions often more focused on the immediate short term issues rather than long term opportunities.

Localisation – few SMEs take a global or even a European view of their business. Focusing only on the UK or their local area. The UK only represents around 3.5% of the global market so is highly restrictive for businesses whose products and services could sell into international markets, especially when UK demand isn't growing. Fear of export and lack of Government support often prevail.

Non Replicable Business Models – in order to grow a business needs to be able to replicate what it does. Many SMEs are constrained by their choice of business model (often centred around one or two key individuals) which limits their potential and places a glass ceiling on growth.

Life Style Focus – many SMEs are simply there to create employment for the founder(s) with no plans for growth beyond achieving a basic lifestyle.

Of course SMEs are only part of the poor productivity story and many large businesses suffer from some of these issues as well. That said, overall SMEs collectively are estimated to be only around 84% as productive as the UKs larger businesses, who they themselves collectively are significantly less productive than many of their contemporaries in other countries.

An additional factor for larger businesses is the shortage of good labour, a problem that is made worse by the fact that around 60% of the UKs private sector workforce work in SMEs where they are typically being less productive than they would be working for a larger company.

There is no easy answer to the SME productivity issue. The UK Governments past and present are clueless about the problem and what little funding they provide the SME sector is often poorly targeted and as a result wasted. The investment market of Business Angels, Venture Capitalists and the numerous online sources are too few in number and are overwhelmed with requests for funding with only a few percent of SME applications ever receiving funds.

Does the whole SME sector need a rethink? Should it be so easy to start a new business? Should business founders need to meet certain skills criteria? Should requests for a start-up business first be assessed before being approved in order to ensuring adequate funding is in place? Should Government be taking a stake and funding the most promising businesses? Should larger businesses be encouraged to partner and support smaller ones? Should Government support be greater and more targeted?

There is no one obvious answer, or should we just accept that poor productivity is the price to pay for our freedom to run our own businesses? All food for thought.

If you would like to improve your business growth and or your chances of obtaining external funding then take a look at our website www.purepitchdeck.com and our online training course for SMEs. With six hours of narrated slides we show you a proven structured approach to business planning and development concluding with the production of a professional PitchDeck.

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