Ep. 13 Productivity Puzzles podcast transcript

New Business Formation and Productivity

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BvA: Why do we need new firms? How important is business creation for employment and productivity? What did the Corona pandemic do to the churning of businesses? We are going to find out. Welcome to Productivity Puzzles.

Hello, and welcome to the 13th episode of Productivity Puzzles, your podcast series on productivity brought to you by the Productivity Institute and sponsored by Capita. I'm Bart van Ark and I'm a Professor of Productivity Studies at The University of Manchester and I'm a Director of the Productivity Institute, a UK-wide research body on all things productivity in the UK and beyond.

Today we are going to talk about business dynamism, which is about the birth, the growth and the decline of businesses, also sometimes called churning. The evidence shows that churning is good for the creation of new jobs, good for providing opportunities for firms and industries and regions to invest and to grow – and of course, important for our discussion today, it's a key driver of productivity. For example, ONS, the Office of National Statistics, just published this week, data that shows that while older firms in the UK are the most productive it is the younger ones that show the fastest growth in productivity. But there are differences in business dynamics across industries and also differences across regions, which we'll talk about a bit today.

But we also know that business dynamism has lost steam over the past decade – that's pre-pandemic – and we're still trying to grasp what happened. It's not just a UK phenomenon but perhaps it's a bigger challenge here than in other comparative countries. And then we saw COVID in 2020 arrive, and while we first saw a big overall decline in new firm creation, and also in firm exits, there have been some sectors and some regions that actually then saw a revival in business creation, at least in some sectors of the economy.

So, was this just temporarily or are we perhaps entering a new age of business dynamism? And importantly, how does the business environment need to change and what policies need to be in place to see more new firm creation? And equally important, how do we make sure that those firms can grow, because that is what we need most for them to become productive?

So, there's a lot to talk about and as always I have the honour of being joined by three experts in the field, looking at these issues from different lenses. First, we obviously need to understand the data – and who else to talk to about this than an expert from the UK Office of National Statistics, Jakob Schneebacher. Jakob is an economist researching business dynamics and management practices at ONS. Jakob, welcome to this podcast.

JS: Thank you, Bart.

BvA: Our second panellist is Anthony Impey, CEO of the Be The Business, which is an independent not-for-profit organisation helping businesses, especially small and medium enterprises, to improve their performance. And Be the Business is also a formal partner of the Productivity Institute in engaging with businesses across the UK on productivity matters. Anthony, great to have you on here today.

AI: Great to be here, Bart.

BvA: And to fulfil our objectives to look at these issues from all perspectives, we are also joined by a practitioner who works every day with small businesses. Clare Elsby is the Head of People and Culture at Elsby & Co, which is an accountancy firm specialised in the SME market. But Clare is also invested with the Federation of Small Businesses, as policy lead for the East Midlands, and co-chair of FSB's Big Ideas group – and we need big ideas on this podcast, so welcome Clare, good to have you on.

CE: Thank you.

BvA: So, let me start right away then with you, Clare, from a very practical perspective, why does business dynamism matter in your view? What makes startups special, what do they mean for growth of employment, productivity innovation, regions? And what are some of the key dimensions of new business creation that you think are really important to think about?

CE: Wow, that's a big question. Why does business dynamism matter? For me I think it offers the opportunity for disruptors to emerge – we all are aware of Uber and what that's done. So, that in turn breeds competition, forcing businesses to innovate, become more efficient and ultimately more profitable. In essence, it raises the bar.

So, what makes startups special? It really does take a special type of person to risk setting up a business on their own. There needs to be an entrepreneurial spirit and you have to be prepared to work all hours, sacrificing family time, financial benefit, for a belief that your business will actually make it. Essentially you are the risk-taker and you have to be ever the optimist.

So, what do they mean for growth, employment productivity, and innovation? Well, the potential is huge. According to an FSB study Spotlight on Innovation done in July ’18, business owners with fewer years in business have higher growth expectations, and that might be down to their optimism. The rate of growth in their first year is higher, but as the business develops the inherent growth rate falls, and that would be my concern.

And what other dimensions of new business creation do you think are important? SMEs are known for their contribution to the local economy – for one pound spent for every SME 60p stays in the local community, and that could be sponsoring the local football team or the amateur dramatics society or the swimming gala. So, therefore a positive environment where startups are supported and encouraged is hugely welcomed.

BvA: Well, that’s a great start and some really important identifiers why small and new businesses really matter. Jakob, you’re a researcher looking at this from an analytical perspective; when you hear Clare talking about these characteristics, does that align with what you’re finding in your research and your analysis of the data?

JS: So, first of all, thanks again for having me on the podcast, Bart. I think we can argue what are, sort of, the most important characteristics of new businesses, but the data certainly show that new businesses are different along a number of dimensions. So, you mentioned the recent labour productivity figures at the firm level that ONS released. And just as you said, we can see there that both younger firms and smaller firms generally tend to be less productive, but that this relationship levels off, meaning that young and small firms are also the ones that see the largest productivity growth as they grow older and bigger.

Another interesting dimension in the data that I think is important is job creation and job destruction. Again, we have some research out that shows that while microbusinesses as a whole do not meaningfully contribute to job churn, young microbusinesses are really important for this turnover in jobs.

And then, finally, I think I want to pick up something that Clare also mentioned, this idea of new ideas entering the economy. Sometimes people refer to this as creative destruction. In our work on management practices we find that when we compare firms of the same size in the same industry and region, younger firms tend to have significantly better management practices. So, maybe this is one way that they bring innovation and disruption into the economy even before we can see it in the labour productivity figures.

BvA: That's very interesting. So, a lot of what I hear the two of you saying is, it's just about these new firms tend to be very innovative. It's kind of in their genes to innovate, that's why they started that business and, you know, they don't have to organise it – it's there because it's somebody who started that new business.

So, Anthony, one simple hypothesis is indeed that these firms grow productivity faster simply because they have innovation in their genes, but on the other hand it's also true that, you know, more firm entries create challenges for incumbent firms. And, you know, we all like competition but we also know that these big firms are actually big productivity leaders – they usually have high levels of productivity. So, you know, in the economic literature we sometimes say, there are two Assume Peters, right? There's Assume Peter who talks about innovation and one part of Assume Peter says, we need competition because it helps for innovation. The other Assume Peter says, we need large firms to do a lot of R&D and a lot of innovation. So, what are your thoughts on this? I mean, competition is good for growth, but size and scale is also good for growth – so where do the small businesses fit in?

AI: Well, you're absolutely right, there is definitely a tension that exists between…you know, is the entrance of new firms into a sector a good thing for incumbent operators, or a bad thing, and how does this play through for productivity? And I have to say, I think that while this tension exists I think there's been some massive shifts in the economy over the last ten years, especially over the last ten years, where we've seen massive disruption, in every part of the economy in fact. And I think that that means that big businesses, more than ever before, are embracing this principle of creative disruption, and are in fact in many instances looking to small firms as the driver to make that happen.

And as an example to this, Canary Wharf in London operate a centre called Level39, which is a sort of a space for startups and new firms in the fintech space to congregate and develop their ideas right in the heart of the financial district, in order to support Canary Wharf's tenants embrace business creation and new ideas, and this principle of creative disruption. So, I think it's very interesting how actually, you know, we're seeing this shift of large organisations recognising that if they want to be at the forefront of innovation, if they want to drive their research and development in the right direction, and if they want to avoid being the next Kodak or the next blockbuster, that actually they've got to lean into this process and not be defensive to it but in fact embrace it and build new versions of their organisation on that basis.

I think it's also worth…you know, just another example that I've come across very recently. I was talking to a very early stage entrepreneur, or two entrepreneurs in fact, who have set up a business that is in the music industry. And the business they've set up is called Catalyst Collective and it is to provide the music industry a new platform that can connect musicians with venues. And I was struck by the use of technology, but especially, sort of, the innovation they were trying to drive in processes.

And I think, you know, that is one of the things that small businesses and the creation of new businesses are so very valuable to achieve. It's not about new, sort of, game-changing technology, but very often it's new ways of running processes that actually drive change. And I think in the context of productivity this is fundamentally important, because actually by driving those process changes it helps really boost productivity, whether you're a large company or a small business.

So, I think there's some very exciting things happening, and while this tension definitely exists within economic theory, I would argue that actually what we're seeing more is more collaboration, more convergence between large and small businesses that actually mean that, you know, we're making some quite significant step changes in how we approach productivity, innovation and all the good things that come off the back of it.

BvA: Yeah, I think what you're basically saying is, a healthy economy needs large existing businesses that have been around for a long time, but it needs small businesses – and it's that interaction, it's the collaboration between them that is really important. Clare, before we move on, very quickly your response to this because, you know, you do a lot with small businesses – do you think actually that integrating small businesses and having in-supply chains formally, or informally through collaboration with larger businesses, is a critical element for their success?

CE: Oh definitely, and that's one of the things we want to actually see when the UK Prosperity Fund comes out, when it's finally announced, we want to see opportunities. We see opportunities for procurement with councils and that's one of the things we're trying to encourage local authorities to do, and actually incorporate smaller businesses in with the larger businesses because we see that they can coordinate that. But at the moment we're not quite there yet, the procurement systems aren't there, and we really need to resource local authorities better to allow that to happen. And there are other forums which let that happen but I think it's a really good opportunity for local authorities to coordinate that, on big projects.

BvA: Jakob?

JS: Yeah, and I'm sure we'll talk about regional patterns a bit in more detail later, but I would just say that the spatial patterns would definitely back up what Anthony and Clare are saying. The same regions that have the largest and most productive businesses, primarily London, also have the highest rates of business births and deaths.

BvA: Okay, let's move on now a little to getting a little bit more grip on the numbers and, Jakob, I'm going to start with you there. So, how large in an average normal year, you know, things have been very volatile for the last few years, but in an average normal year how large is the share of new firms in the business population? And also, when you talk about numbers can you also talk about, because we haven't talked about it yet, about exits or business deaths, if you like, because that's part of the same churning process?

JS: Yeah. Let's take a very concrete example. So, in 2019, the last pre-pandemic year, the rate of business births across the UK was 13 per cent and the rate of business deaths was 11 per cent. This is very much in line with other post-Great Recession years. I mean, I think what's interesting here beyond the numbers themselves, and perhaps worrying slightly, is that the birth rate is slightly higher, and has been consistently slightly higher than the death rate, meaning that on net the business population is growing. And this mirrors research in other countries on the emergence of so-called zombie firms, since the Great Recession – so small, low-productivity firms that nonetheless survive and tie up resources and talent that could otherwise go to new entrants.

On the other end of the spectrum the ONS also tracks what are called high-growth firms and these are firms with at least ten employees that grow at 20 per cent or more for at least three consecutive years. And again, to take 2019 as, sort of, the year to anchor the numbers to, there were about 13,000 of those firms, or about four and a half per cent of all firms, with at least ten employees.

BvA: And do you find in the data that these new firms grow productivity faster, if that's something you can get from the data?

JS: So, I think the best evidence we have from that is this recent publication on firm level productivity that my colleagues put out earlier this week actually.

BvA: Yeah, we'll put that in the show notes so people can actually download it from there. Go ahead.

JS: Exactly, and so we definitely see a positive but slowing relationship between age and labour productivity, so the youngest firms grow the fastest and that growth eventually levels up.

BvA: So, Clare, I just want to deep-dive a little bit more into the type of new firms, because there are obviously very different types of firm, right? So, what types of startups do you distinguish? I mean, there are, you know, high digital startups, very fast growing, but there are also people who just start a little business on the side. So, when you think about small businesses how do you categorise these various groups?

CE: So, we see many many different types of startups and they could be in all sorts of different sectors, but the one that we think that will be the most successful and obviously the most productive, is actually a sustainable one. It might sound very trite but we see a lot of businesses where either the original idea has not been fully researched fully, the person running the business is not the best suited to be that entrepreneur, and they literally haven't got the cash behind them. And with all businesses cash is still key even when actually starting up.

But I guess, the most innovative sectors at the moment would be the green renewal energies, insulation, anything to do with reducing our carbon footprint – those would be the high-growth, high-innovation sectors that we are seeing more of, and certainly people are getting more interested in getting involved in.

BvA: Yeah, and after the break we're going to talk a little bit more about policies and some specific policies maybe directed to those groups. But on the numbers, Jakob, let me go back to you on the other thing that I mentioned also in the introduction. We've seen a bit of a slowdown in new business creation over the past decade, the pre-pandemic decade; the numbers you gave are sort of an average for the years, but all post-financial crisis. Before the financial crisis in 2009 it seems business creation was faster. So, what has happened to that trend and this decline in business dynamics?

JS: Yeah, that's absolutely correct, Bart. So, since the Great Recession in 2007/2008, business dynamism by most measures that we have has declined. For instance, in experimental statistics that ONS published last year that cover the entire time period from 1999 to 2019, we see a marked decline in the amount of job churn attributable to firm entry and exit. The fall is larger for job destruction than it is for job creation, and this fall in job destruction from firm exit can be attributed primarily to microbusiness, so those are businesses with less than ten employees. The overall trend, though, holds across all industries and we can therefore assume that the root causes are also economy-wide.

And finally, I'd add, if I can, that this pattern by the way has also been observed in other countries. So, the US in particular has been quite well studied and there's now a broad literature that documents declining economic dynamism more broadly over recent decades. So, people have looked at a rise in market concentration, so markets that become more concentrated; a fall in the labour share of income; a widening gap in productivity between the very productive frontier firms and the laggards; falling rates of firm entry and job churn; and overall of course the slowdown in productivity that I'm sure listeners of this podcast will be very familiar with.

BvA: Well, actually that's a great lead-in to what I wanted to ask Anthony here because the question is, how much is there a UK-specific problem with this decline in business dynamism? And I think you alluded earlier to the fact that we do have this issue of, sort of, this low-wage low-productivity path that many small companies have been following in the past decade or so – is that a specific UK problem and, if so, how would you identify and characterise that?

AI: Well, I think the problem is best articulated by the fact that it takes a UK worker five days to do what it takes a French, German or American worker to do in four. And so, I certainly recognise that the trends we're seeing within the UK are happening elsewhere; the trends are just more pronounced within the UK. And I think that, you know, certainly when we look at, say, the takeup of technology by smaller businesses, the UK is, you know, quite a long way behind our international peers. So, there was a study by McKinsey that found that 62 per cent of large firms in the UK, and 68 per cent of German large firms use CRM systems. So, you know, just on that metric there is, sort of, a lag between technology adoption within the UK and elsewhere. So, I think, you know, we're not as good at enabling the adoption of technology by firms.

I think there is also a challenge around the management capability. And I say that very very cautiously, because I know lots of small business leaders – I spent my career before Be the Business being one myself and running businesses and, you know, of all the people I know I wouldn't dare say to them that they don't have the capability to run their organisations, because they are superb at running their businesses. But I think very often they don't have immediately available some of the tools and resources that larger firms have. And some of that is down to access to skills, and some of that is down to having weak cash flows and lower profits to be able to afford the skills that might help their business become more productive.

But I think that that shortfall, however it's come about, does mean that it's more difficult for a leader of a small business to really drive productivity than it is for their peer in a larger organisation. So I think, you know, certainly we see at Be the Business this challenge around tech adoption and management skills within small businesses. And I think if there were two things that we could do to help accelerate productivity and get out of, sort of, this low tail of low-productivity businesses, it would be to enable businesses to adopt technology more easily and to give them easier pathways to improve the skills within their organisations.

BvA: So, in a previous podcast, the one before this one, we talked about some work around the relationship between productivity and compensation. And we find, a lot of research finds, that there's been a bit of a disconnect here – even though productivity grew slowly, compensation grew even slower. And one of the concerns is, particularly in many of these small firms, wage growth has really stayed behind growth of productivity. And particularly if we all say, well, actually smaller companies are the ones that actually grow productivity faster, it's worrying that quite a few of these companies don't pay very well. Would you agree with the fact that actually, you know, incentivising people and workers in terms of being more productive and do all these things that you are mentioning, you know, better skill formation, adopting new technologies, that there has to be a compensation element to this as well? Clare, let me start with you.

CE: Yeah, I mean, I completely agree with what Anthony's been saying, but I would actually say that things are changing and that things are changing rapidly. So I don't know whether these are coming through in your figures yet, but certainly in our business and all the clients we're speaking to, wage rates are going up. We're having to introduce staff benefits that we've thought about in the past but never actually done.

I do actually think as well, with COVID, adoption of technology has increased rapidly. It started off with small firms through making tax digital, but that only applied to VAT-registered businesses. And with actually people having to work from home they got much better at using technology, and now we're seeing businesses early adopting Cloud computing, Cloud packaging, which then lends itself to this whole ecosystem of apps. And we've got several clients that run their whole businesses just from their phone – but that's only starting. And I think part of the problem with small businesses is that we are very, we'll do the innovation in-house, we'll do it ourselves. We're sort of self-innovators really and we don't tend to share that technology, we just get on with it and do it.

But these are small incremental changes, and if you pace that out across the whole of the SME population, the scope, if you support that in government policy, and provide that environment, could be huge. And my argument would be that actually we should be supporting those businesses in tech skills, training, management to adopt those kind of innovations that are only small. A bit like the British cycling team, it's that one per cent difference, which if you spread it across all our small businesses will have a huge impact. And the government I think at the moment concentrates the huge efforts on startups and, like Jakob said, those, I would call them gazelle-type businesses, where they're high growth, potentially increasing turnover by 20 per cent a year. And actually it's that bulk, that middle bulk, that is our backbone of our economy and we need to encourage them.

BvA: You know, so I think in a way you're saying that actually the labour shortage crisis that's actually coming down the road is actually correcting this disconnect between productivity and wage growth. Anyway, so a few things we're going to pick up after the break. One thing we need to talk about briefly after the break is what happened during the Corona pandemic, which I alluded to a little earlier, but then we also spent most of the time on what kind of policy measures is the government, or should the government put in place at national and regional level, to really allow new businesses to grow faster. But before that, let's take a short break to hear about what else is happening at the Productivity Institute.

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BvA: Welcome back to my discussion with Clare Elsby, Anthony Impey and Jakob Schneebacher on business dynamism and what it means for productivity and other business and performance measures. Now, before the break I already alluded to the fact that the slowing trend in churning suddenly got somewhat interrupted during the COVID pandemic. We first saw an initial drop, but since then it seems that new business registrations have actually gone up, and business exits actually dropped off, at least for some time. So, Jakob, very briefly give us an idea of what happened with these trends in COVID '20 and '21, and then of course, will you can talk a little bit about what that means going forward?

JS: Yeah, thank you, Bart. So, business creation and destruction in the last two years has indeed looked quite different from what we're used to. So, let's start with business deaths maybe. In the initial phase of the pandemic we saw a rapid fall in the number of business deaths in virtually all of our measures. This has since been reversed and now exceeds pre-pandemic levels. And again, let me just emphasise that these trends are not unique to the UK but can be seen in the US and Canada and Germany and France and the Netherlands and so on. On the side of business births, depending on the measure that you look at, we sometimes see a bit of a small dip but then always followed by a strong increase that has since levelled off, although cumulatively we probably still see more businesses than we would have in the absence of the pandemic.

Now, underneath these headline figures we see some interesting COVID-specific trends. So for instance, for 2020 ONS figures show that the highest birth rate is in the transport and storage industry, which includes delivery services. Similarly, there is research by columnists at the University of Kent that finds evidence that there were more new company registrations in areas with higher Eat Out to Help Out density, something that they attribute to demands for low births from increased footfall. And finally there's also preliminary evidence coming from the Bank of England that suggests that new company registrations in the pandemic were coming predominantly from inside existing enterprise groups. So, this might tell us something about the hurdles that startups are facing.

BvA: Yeah, so it might just mean that some of the productivity uptick that we have seen was just a result of the least productive entities, you know, temporarily or permanently, not playing a role in the economy and then new businesses actually entered and created a further opportunity for growth. So, Anthony, let me ask you here, how much does this all matter now? I mean, hopefully we're leaving the worst of the COVID pandemic behind us now, and we need to look forward. But the question is – this huge disruption that we have been seeing in the last two or three years, how important is that for thinking about business dynamism going forward?

AI: Well, I mean, I think we've seen three big trends that have emerged around businesses being much more comfortable around adopting technology, businesses being more ready to embrace innovation – and early on in the pandemic we recorded three years worth of innovation in three months, early on in the period of lockdown. And we've also seen businesses adapt their management practices and bring in new expertise into their organisation, in the face of these enormous pressures that businesses were suddenly confronted with in March 2020.

I think, you know, this discussion about the impact of the pandemic is very useful as we look at the current situation that businesses find themselves in, in that they are under massive inflationary pressures. There is a huge impact to supply chains, and in fact just a few moments ago received an update around how, you know, some parts of the economy that are dependent on particular raw materials are facing complete shutdown because the supply of raw materials that are either coming from Ukraine or Russia have just stopped. And that then has this huge domino effect throughout supply chains and we can't underestimate the ripple effect of supply chain disruption.

And then the third thing is there's a very real skills crisis, and I speak to employers every single day and every single one tells me that one of their biggest challenges is hiring people and retaining people. And so, you know, these are massive challenges that businesses are facing today. And to some extent the crisis created by the pandemic has helped businesses be more resilient and more able to navigate the massive levels of uncertainty than ever before. But I think, you know, these very very real challenges place huge commercial pressures on organisations, which to some extent force organisations to have to become more productive if they want to survive.

So, I think the pressures are enormous, we cannot underestimate how significant they are. I would potentially argue that what we're facing now in the economy potentially will have a bigger impact on business than in fact the pandemic has had. You know, I really hope that the trends that we've seen, this adoption of technology, the rate of innovation, that acceleration of the rate of innovation, and that willingness to develop management capabilities within businesses, we are well equipped to navigate whatever the future holds.

BvA: So, what you're really saying is, you know, on the one hand the pandemic basically pushed us to make some big changes in the way that we're running our business through digital, through better management and everything else, and at the same time we're hitting a huge amount of new challenges literally today.

AI: We're like a mountaineer and we've just scaled the toughest mountain-face ever, we've got to the peak and we think, hurrah, we've got to a peak, and we look up and there's another mountain peak ahead of us. And that is the challenge that business leaders across the country in every part of the economy are facing today.

BvA: Great visualisation, and just to carry on with that – so now that we're on a mountain peak we can actually look out, even though it may be a bit cloudy and misty but at least, you know, we may be able to look forward. So, Clare, let's talk about the policy environment and again particularly for new business startups. So, the situation that Jakob and Anthony just described – do we have the right policy instruments in place for small startups to get going, to grow their productivity, to get integrated in supply chains and collaborations and partnerships that we talked about before? It seems to me that you have concerns about the fact that the policy environment is still not what it should be to really maximise an opportunity that small businesses have ahead of us?

CE: I think if you're specifically talking about startups, Bart, there is plenty of help out there – local enterprise partnerships, universities are all collaborating in providing help and advice to new startup businesses, in all kinds of sector. So, I think if you're starting up there is…and that help and advice is free as well.

So, it's the problem of what do you do once you've started up and how do you take that next step? And therefore I would hope that we can see policies aiming at…and Anthony mentioned it, about management training, so I would take it as far back as entrepreneurship training and take it to schools, so that actually going into business is something that is on the curriculum. I've done a lot of work in the past with talking to schools, in fact I was talking to a school yesterday, and I was really surprised to hear from them, and this feeds into digital skills, is that they don't use Excel any more. They're a Google school, this particular school. And yet every business I know, well, apart from the creatives, I'll give you that, all use Excel. So, it's just if you're cutting off children at the age of 11 to not use packages that businesses use on a day-to-day basis, where is that taking us? So, it's those decisions really that need to be made in the round.

We need access to affordable finance. It's relatively easy for a larger business to actually get finance – they have the capability, they've got finance teams to put the budgets and the cashflow forecasts together – a small business doesn't have that.

There's the situation of grow-on space – we're hugely lacking in the regions right across the UK in grow-on space. Now I'm not talking about office space – there is actually plenty of office space available, and part of that is due to the pandemic itself. But it's those roller-shutter doors, it's that dirty engineering space that we need for those small businesses to grow from their garages and actually take the next plunge – and we just don't have that space. It's expensive and it's a commitment, it's a lease commitment, it's not necessarily easy in/easy out rental space.

Rural broadband is a huge issue as well – we need connectivity right across the UK. Where I am they've just introduced 5G but that is a three-mile radius of the time – that doesn't go any further and one of our offices is two miles outside that. So, we're completely missing that connectivity in the UK.

And then, again, going back to the digital skills of the employees, there's another factor which is huge. We're talking about standing at the top of the mountain, but what we're doing is we're standing at the top of the mountain having a massive amount of increased debt. We've invested, we've borrowed CIBILs, bounce-back loans. Lots of small businesses actually confuse personal credit card debt with business debt and therefore they've maxed out their credit cards. So, we're not starting at the bottom of the next mountain with a sort of…at ground zero, we're actually carrying all this debt. So, we need government policies to recognise and help that, and with increased interest rates, that is not going to help the situation – even so far as just simply getting paid on time.

One in ten businesses, according to a recent FSB study, said that they worried about the very viability of their business because they weren't getting paid on time. Every business deserves to be paid within 30 days if they've done a good job. So, it's things that we can all do and things that certainly government can help with.

BvA: So, a recurring theme that I hear, starting a business isn't that difficult – growing it is hard. That's basically the bottom line. And it's in that growth process where companies face a tipping point of, you know, having a few employees or no employees to actually setting up a serious management structure with managers in different functions and a board room, that's where the hurdle needs to be made. Now, how much of this is just good entrepreneurship and company practice, you know, and how much do we need government for that? And maybe a little bit related to that also, how much of that is national government policy, you know, some of the finance issues that you're raising for example, how much of that is really, sort of, regional or local policy, bringing businesses together, creating platforms where they can collaborate, where they can work with the education system to identify skill needs and things like that?

CE: I think there's actually a drive, especially with the UK Prosperity Fund we don't know what format that's going to be and we don't even know who's actually going to deliver that. But there is going to be…we see more localisation, potentially more mayors. I think the local authorities are going to get involved a lot more in business engagement – and they need support. And if they've got that support then certainly there's a lot more that can be done collaboratively. And then they've got the opportunity, I think as I said before, to join the bigger businesses with the smaller businesses.

But yes, I always see it, Bart, as a sort of a step…going up a set of stairs and you reach the top of the stair, and then you go level for a little bit and then suddenly you've got another step to go up – and that is hard work and it takes commitment and it's a risk for business takers. And possibly one of the answers for the UK is that actually how many people want to actually take that risk? And it very much depends on where they are in their business cycle as to whether they actually, you know, want the hassle of it really.

So, for me, we've got to make it…there's got to be incentives and the government can do a lot. So for example, R&D tax credit, patent box tax reliefs, the super deduction – if they can be made more small small, microbusiness-friendly then there'd be much more of an uptake with that. At the moment they're aimed at the bigger corporates and the corporate are the ones that are taking it up, and actually in my mind they're the ones that don't necessarily need it. It's the bulk of the medium sized, small firms, they're the back bone and they need that incentive.

BvA: Anthony, I'd also like to get your take on this issue to what extent support policies in this space need to be startup specific, small new business specific, and to what extent do we need a targeted startup policy first as just good government policy at national and regional level to allow businesses to do what they need to do?

AI: Well, I think there is always a danger if the answer to every question is the government needs to fix it so, you know, I start from a point of actually what is government good at, and what should we lean on government in order to try, but actually what is the business community really good at and what role do the business community play?

I think it's very dangerous, by the way, to ignore what I would call the middle majority of businesses. And I think, you know, the high-growth businesses are very exciting and they're very glamorous businesses but actually they get quite a lot of support already, and they need that support because they are an important part of the economy. But actually the middle majority is the bulk of businesses in this country, and actually Clare I think said it a bit earlier on before the break, you know, if we can move the productivity of that group up just a little bit in aggregate, it has a big impact on the performance, the macro picture for the country. So, I think it is very dangerous to say, oh well, you know, they're just not exciting enough businesses so we're going to ignore them. I think that is a very dangerous place – and it is a massive opportunity to miss if we approach it from that perspective.

I think, you know, one of the challenges of addressing this problem, though, is an oversimplification of how small businesses are treated and how the challenges of small businesses are sort of all put into one bucket. And I think the term SME is, you know, partly to blame for this because SME addresses all those businesses that employ one to 249 people in every sector of the economy. And the reality is that that is a very complex and diverse group of businesses, and to just put them into one bucket and try to design policy to address that single bucket kind of misses the point entirely. So, I think we've got to be much more sophisticated in how we understand small businesses.

I think in addition to some of the things that Clare's highlighted about the role of government, I think also government have immense convening power, and the great thing about convening power is that it doesn't cost government very much to exercise. And I think that there is a role for government to play to encourage big businesses that are great at running productive businesses, and sharing their best practice knowledge with that middle majority or those businesses in that long tail, because actually if we can share knowledge from end of the graph to the other, that will have a huge impact on how productivity is approached by small businesses.

I think one final point that I just want to make is just regarding the narrative around growth. And I think there tends to be a real emphasis on growth businesses are good business, and I think that again misunderstands the priorities for a lot of business leaders. In fact some research that we've done quite recently shows that nearly half of small businesses are not interested in growth. Now, I think that's because when we talk about growth we talk about…you know, the perception is, that means more sales or more office space or more shops or more of something. And actually for a lot of businesses they want to run their businesses as a particular size – but that doesn't mean that they don't want to grow.

And their growth might come through…and almost certainly, you know, their requirement is for growth to come through productivity, because what you see with small business leaders in particular is that they work really really hard. They're working five or six days a week, 12 hours a day, you know, they're putting in the hours. And actually if the growth we talk about isn't about those topline turnover or office space or shops, or whatever it might be, but actually the growth is growth in productivity, I think you'd get a lot more small businesses engaging with government policy. Because actually, you know, the prospect of growing and winning back time is probably the most precious thing that lots of businesses leaders want. And giving them that time might actually then lead to those business leaders feeling comfortable with these more traditional approaches, these more traditional understandings of what growth means.

BvA: Yeah, that's a fascinating thought. So, Jakob, any final thoughts from you?

JS: Yeah, I think we heard some really interesting views from the ground from both Anthony and Clare, and I'm in the comfortable position to be able to say that our data supports points that both of them have made. So, first of all, we do see…even if we leave aside the growth angle, we do see a distinct difference in the adoption of management practices between large firms and small firms, in particular firms with less than 50 employees, and in particular less than 20 employees are much more likely to be in this long tail of firms without almost any structured management practices.

The good news, and this I think also ties in quite nicely with some of the things we've heard Anthony say about innovation in the pandemic, is that actually in our latest wave of the data that relates to 2020 we see a distinct catchup among management practice adoption precisely by those small and medium enterprises. So, I think that's a very optimistic thing to end on.

BvA: Yeah, always good to end on optimistic notes. I think and I hope the listeners think it as well that this podcast did achieve what I hoped it would and that is that we get, you know, a strong data and analytical perspective combined with real practice on the ground. That's really what Productivity Puzzles and, frankly, the Productivity Institute is about and I think you really achieved that, so, Clare Elsby, Anthony Impey and Jakob Scheneebacher, thank you very much for your participation in this podcast.

CE: Thank you, thank you for having us.

AI: Thank you.

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Productivity Puzzles was brought to you by the Productivity Institute and sponsored by Capita. And this was me again, Bart van Ark at the Productivity Institute. Thanks for listening and stay productive.

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