

# Future champions

Unlocking growth in the UK's  
medium-sized businesses



## MSBs: the UK's forgotten army

Medium-sized businesses (MSBs) make up a dynamic sector of corporate Britain that has the potential to be a powerful engine of growth for the economy as it forges a path to recovery. Yet for too long this potential has been overlooked and neglected by government, financiers and the media.

If the UK can create the conditions that have enabled MSBs in other countries to flourish, we believe that would enable them to play a vital role in transforming the UK's economic growth over the next ten years, contributing as much as £50bn to the economy by 2020, and creating job opportunities across all regions of the UK.

This report shows how the UK needs to do more to drive forward and celebrate the success of its forgotten army of MSBs.

Five figures that highlight the need for action:

- Harnessing MSB potential would unlock £20-50bn of economic output
- MSBs make up 1% of firms but 22% of revenue and 16% of employment
- MSB productivity has grown at 0.5 percentage points below large firms
- German MSBs contribute twice the share of jobs than UK firms
- Fewer than one in ten MSBs access the equity markets.

### About this report

*Future champions* is based on detailed discussions with senior executives at more than 100 businesses, and a telephone poll of a further 100 MSBs from across the UK to understand the strengths and weaknesses of this sector and the threats and opportunities they face. We have also used analysis provided by McKinsey & Company to identify the main obstacles to growth and potential solutions to unlock growth in this sector.

## The untapped potential for growth?

Medium-sized businesses make a significant contribution to the British economy. They turn over between £10m and £500m, but our analysis has focused on the lower end of this range (£10m-£100m) – firms that we believe face particular challenges to grow. They represent less than 1% of firms, but account for 22% of revenue and 16% of total employment.

## Closing the growth gap

While MSBs make a solid contribution to UK economic growth and job creation, this performance is not shared equally across the sector.

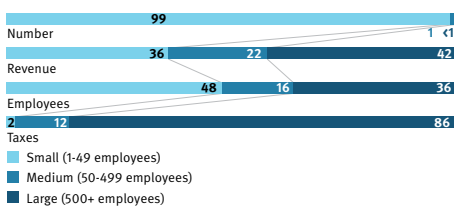
In fact MSBs can be divided into three groups: fast-growing businesses – the gazelles – that are creating the majority of the new jobs, those producing modest but stable returns, and those lagging behind with very low or even declining growth rates.

Despite their contribution to the economy MSBs are often neglected by policymakers, government, the media and the financial community who focus on the UK's smallest and largest firms but often overlook the distinctive needs of those in the middle. MSBs are in a public policy gap: too large to benefit from policies tailored to small business, but too small to win the attention FTSE firms can.

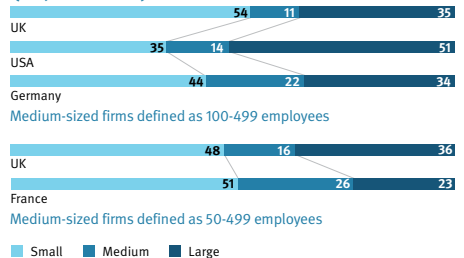
But their contribution in all these respects could be much more if international comparisons are anything to go by. UK MSBs make up a lower share of employment than their counterparts in the United States, Germany and France.

In Germany and France the contribution of this sector to jobs is significantly more than in the UK. The picture is the same with their share of total national revenue where German firms contribute nearly twice as much while French firms are not far behind.

### Exhibit 1 Distribution and contribution of UK companies in different size bands (% total UK)



### Exhibit 2 Distribution of total employment by company size (% , 2007-9)



1 £10m-£100m roughly equates to firms that employ 50-499 people

## Three steps to growth

The full version of this report sets out the three steps to realising this growth potential.

- Generating confidence and ambition
- Building up new skills and competencies
- Plugging the finance gap.

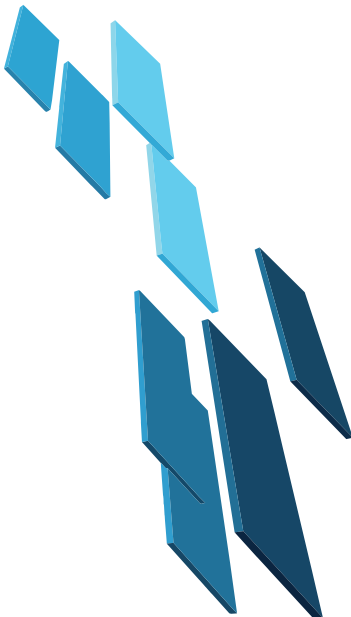
### Generating confidence and ambition

Many MSBs that are barely growing lack the confidence to take on new levels of risk, and lack the ambition to look for new growth strategies. Of the MSBs that the CBI polled earlier this year only just over a quarter expected to grow their business significantly over the next five years.

- MSBs lack a clear identity in the UK
- Owners are reluctant to take on more risk after a certain level
- Current economic conditions have created an uncertain environment for investment.

MSBs tend not to be celebrated like small and large firms and they don't have the same support networks that other firms enjoy. Very little data is collected on them and they are rarely acknowledged in government policy or by the media. While Germany lauds its Mittelstand firms the UK's MSBs have been largely forgotten.

Ownership mind-set and skill-set can prevent some MSBs from reaching their full potential. Some business owners naturally reach a ceiling in their ambition, when further stages of growth mean taking on new levels of risk, and potentially losing the capital they have built up in their firm.



## Building up new skills and competencies

The research undertaken for the report shows that firms themselves recognise the following five factors as critical to their ability to grow:

- Management capability: firms must look to bring in external management, ensure staff are well-educated and that they are aware of management skills gaps
- Ability to harness talent: as MSBs grow the need to recruit the best talent and skills, and source the best advice is paramount
- Choosing the right finance strategy for growth: a wide range of funding options is available to MSBs but most tend to rely on bank debt
- Export capability: MSBs do not export as much as they could and face difficulties in starting to export and increasing their existing activity
- Ability to innovate: firms must look to greater collaboration while tax incentives would help raise R&D levels.

*“We’ve been able to develop and grow precisely because of the time we’ve invested in expanding our nation-wide and international trade networks”*

Geoffrey Riesel  
Chairman, Radio Taxis Group

## Plugging the finance gap

MSBs that want to grow, and have the capabilities to do so, face a choice in how they fund their expansion. Yet they face obstacles to accessing these types of investment capital. We believe this finance gap is limiting the growth of MSBs in the UK.

There are two key areas where financing is a problem:

- Barriers to equity markets: attracting equity investment should be a viable option for mid-sized business seeking to grow
- Barriers to debt markets: costs of raising finance through the debt capital markets are such that it is rarely a practical solution for them.

*“The UK needs a stronger venture capital market so that we can help grow and retain our best innovative MSBs without resorting to trade sales abroad”*

David Kerr  
Chief executive, Bird & Bird

## Conclusion: unlocking growth

### Creating the conditions for growth

The UK faces a clear choice. Settling for the status quo would mean that a large number of MSBs in the UK would remain virtually static, with either declining, or very marginal growth.

The alternative means championing MSBs and developing a plan for growth so that they can thrive, and make a dramatic impact on the growth of the UK economy. We believe that:

- Championing MSBs will increase their ambition
- MSBs must scale up their capabilities
- Plugging the finance gap will nurture future champions.

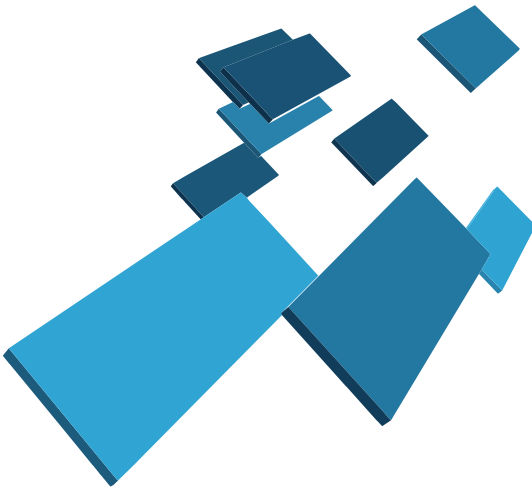
The potential benefit to the UK economy is enormous. Our economic modelling suggests the economy could grow by between £20bn and £50bn or by 0.1% to 0.26% of GDP by 2020.

If we get this right MSBs could also be instrumental in rebalancing the UK economy, strengthening the UK's manufacturing sector, and creating new job opportunities across all regions of the country.

*“Engineered products can have very high intrinsic value and generate manufacturing jobs, but take longer and are more expensive to bring to market. We need innovation support policies that recognise this difference”*

Bob Flint

Commercial director, Ceres Power



## Recommendations

### Championing MSBs

- Government to recruit three more MSBs to the prime minister's Business Advisory Group to ensure that their needs are at the heart of government
- UKTI to take more MSBs on trade delegations, showing other countries that the UK has a strong mid-sized sector that can compete internationally
- BIS to improve the data the government collects on MSBs to influence future policy.

### Boosting MSB skills and competencies

- BIS and trade bodies to establish a cost-effective method of helping MSBs to improve their management skills
- BIS and CBI to showcase the benefits of corporate venturing to both large firms and MSBs
- CBI to bring MSBs together to share experiences of management challenges, financing options and exporting

- BIS to promote Export Enterprise Finance Scheme to MSBs that qualify
- UKTI to proactively target mid-sized companies that should be exporting
- HMT to explore the cost and feasibility of restructuring Entrepreneurs' Relief and broadening the scope of the R&D tax credit.

### Plugging the finance gap

- HMT to explore the cost and feasibility of reinstating the Corporate Venturing Incentive and making the costs of raising equity tax deductible
- BIS to bring industry together to develop the infrastructure for MSB bonds
- HMT to explore the cost and feasibility of introducing an ISA for MSB bonds.

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November 2011  
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Printed by Duncanprint on Revive  
100 Pure White Offset, containing  
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Product code: CAG\_EBU\_194

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