Quarterly Survey of Small Business in Britain

2013

Special topic: job creation and contracting out
Acknowledgements

The Open University Business School enterprise research team would like to thank the many SME owners and managers who invested time and effort in completing our questionnaire. Our aim in this report is to represent their views and experiences as accurately as possible. In doing so, we hope to provide a useful, timely and objective source of evidence about small and medium-sized firms that can be used to inform future policy and practice.

The Business School is pleased to acknowledge Barclays Bank and ACCA (Association of Chartered Certified Accountants) for providing sponsorship and organisational support. It is important to note that the Quarterly Survey is editorially independent and any opinions expressed may not necessarily reflect those of The Open University or other organisations. Your feedback on this report and on our other publications is welcome. Please contact us at: oubse- enterprise@open.ac.uk if you have any comments or queries.

Research and sponsorship opportunities

Are you interested in finding out more about becoming a regular sponsor of the Quarterly Survey, sponsoring a special topic, or commissioning a custom research report on an SME, entrepreneurship or innovation topic? If so, we would be pleased to discuss the options and can provide examples of our previous work, including associated media coverage.

For an informal discussion, please contact the Editor at: richard.blundel@open.ac.uk
Summary

The latest results suggest a slight weakening of the positive sales performance seen in reported in the first quarter of 2013, though there has been a continuation of the positive net sales balance. Employment performance has also declined slightly, producing a marginally negative net balance. Behind these overall figures, we can see some marked variations by firm size. Relatively larger firms continue to report much stronger sales and employment performances than their smaller counterparts. We have again seen remarkably little change in the ‘top’ business problem reported by SME owners and managers. The difficult economic climate, along with the associated negative impact on demand, remains by far the most commonly reported problem. Cashflow, payments and debtors remains the second most commonly cited problem, while government regulations retains its third place overall. As noted in the previous quarter, the findings do not indicate any strong variations by firm size, sector or region. SMEs are again optimistic about the future, as indicated by improvements in overall sales expectations in this quarter, though this is coupled with a slight decline in overall expectations for employment. In both cases, relatively larger firms remain more optimistic than their smaller counterparts.

Special topic: Job creation and contracting out

This quarter’s special topic examines the quantity and quality of jobs being created by SMEs and the extent to which firms may be shedding jobs and contracting out services rather than retaining or taking on new staff. We selected this topic due to the importance of employment creation in national and regional policy agendas and in order to gain an insight into current trends. Our findings provide some encouraging evidence on recent employment trends amongst SMEs. More than half of respondents (53%) report that they have taken on at least one new member of staff in the last two years, and while many of these new employees may have been replacements rather than net additions to the firm’s payroll, each of them represents a new opportunity for the person involved.

- The proportion of firms that has taken on several new employees increases with firm size. The figures range from 63% of respondents in the £5 million+ band to just 8% of those with a turnover of less than £100,000.
- Almost half of the new recruits over the last two years (47%) were employed to undertake core manufacturing or service delivery functions. The next most commonly-reported functions were marketing and customer services, which accounted for one third (33%) of the appointments.
- For our online respondents, the main reason for recruiting was to replace an employee who had left the business. However, almost there is evidence that almost half (48%) were doing so in order to cope with increased workload and some others were taking on new staff in order to pursue growth strategies.
- Almost four out of five respondents (79%) report that they have not contracted out services or employed agency workers for any tasks or functions in the last two years. However, while only 14% of firms in the less than £100,000 turnover band had engaged in outsourcing, the proportion rose to 33% for those in the largest (£5 million+) size band.
- Flexibility was by far the most important reason for SMEs to engage in outsourcing, being identified as the main reason by 40% of our respondents. Outsourcing was also overwhelmingly local, with 82% reporting that contractors were based in the same city or region.
A change of focus: looking forward to Quarter 3, 2013

The Quarterly Survey of Small Business in Britain has been in continuous production since the spring of 1985, making it one of the first and longest-running surveys of its kind. Over the last 28 years, we have responded to feedback and made a number of changes to the survey in order to enhance its relevance in rapidly changing times – we have included a short historical account in the Appendix to this report as a reminder of some of these changes. This edition marks another significant turning-point for the survey. Following an extensive review of our research activities, we have sharpened the focus of the survey around the topical issues that we address each quarter. In Quarter 3, 2013 we will be examining business advice and information in the context of the major changes in the business support landscape over recent years. From Quarter 3, the special topic section will be extended, with additional questions and analysis that will enable us to probe the issues in greater depth. In addition, our new case studies feature will be incorporated into the main report, making it easier for readers to navigate across the full range of quantitative and qualitative findings. We are also creating more opportunities to engage in discussions related to our topics through a new social media group, which will be launched later this autumn. Our dataset on performance, problems and prospects will remain available to researchers in archive form and we will continue to provide informed and impartial commentary on current trends though our review of other leading SME surveys.

Editor, The Quarterly Survey of Small Business in Britain
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Job creation and contracting out

This quarter's special topic examines the quantity and quality of jobs being created by SMEs and the extent to which firms may be shedding jobs and contracting out services rather than retaining or taking on new staff. We selected this topic due to the importance of employment creation in national and regional policy agendas and in order to gain an insight into current trends. Online respondents provided additional comments, which have been incorporated into relevant sections.

Introduction

Governments in the UK and across the EU acknowledge that SMEs need to play a central role in the economic recovery and in creating new jobs. There is strong and growing evidence that a small proportion of young, high-growth rate firms (or ‘gazelles’) account for a high proportion of overall employment growth¹. However, there is relatively little information on patterns of recruitment and job creation across the full range of SMEs, or about the quality of these new jobs². At the same time, there is evidence that some firms are shedding staff (i.e. ‘job destruction’) as a response to prevailing economic conditions. In this special topic, we ask SME owners and managers about their recent recruitment experiences. We also explore the under-researched question of how far SMEs are choosing to outsource services as an alternative to employing their own staff, and probe the reasons behind these decisions³. A trend towards outsourcing of white collar jobs has been identified in other countries including the United States⁴, but is there any evidence that it has become widespread amongst the UK’s small and medium-sized firms? We begin by examining where the new jobs are being created and which roles are currently in greatest demand. This is followed by a review of the latest evidence on out-sourcing where we probe for the key reasons why SME owners and managers decide to outsource particular tasks, while others are kept in-house. Finally, we draw out the main conclusions of the study and comment on the likely impact of these developments on the UK government’s growth agenda.


Recent employment trends

We asked respondents if they had taken on any new employees over the last two years. Our survey findings suggest that, despite continuing concerns over the state of the economy, many SMEs have been actively recruiting new staff. More than half of respondents (53%) report that they have taken on at least one new member of staff in this period. This figure includes a sub-category of businesses (9%) that have taken on their first employee. In addition, almost one third (31%) of firms have taken on several new people since 2011 (Chart 1).

Chart 1: Have you taken on any new employees in the last two years?

At first sight, these figures might seem out of line with data reported in our Performance section, where the percentage of firms reporting an overall increase in employment over the last year is 17%, a figure that has only varied by a one or two percentage points over several quarters (Table 10). The difference is likely to be due to the following factors. Firstly, there is evidence that a high proportion of these new recruits (59%) are replacements for employees who have left the business (see Chart 3 below) and would not therefore result in an overall increase in employment. Secondly, this question relates to a longer (two year) timeframe, so is likely to capture twice as many instances of staff recruitment as those reported in the Performance question.

The proportion of firms that has taken on several new employees increases with firm size. The figures range from 63% of respondents in the £5 million+ band to just 8% of those with a turnover of less than £100,000 (Table 1).

Table 1: Firms who have taken on new employees in the last two years, by turnover

<table>
<thead>
<tr>
<th>Turnover</th>
<th>None</th>
<th>One (first)</th>
<th>One (not first)</th>
<th>Several</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than £100,000</td>
<td>78%</td>
<td>9%</td>
<td>4%</td>
<td>8%</td>
</tr>
<tr>
<td>£100,000-£249,999</td>
<td>63%</td>
<td>9%</td>
<td>9%</td>
<td>19%</td>
</tr>
<tr>
<td>£250,000-£499,999</td>
<td>45%</td>
<td>10%</td>
<td>19%</td>
<td>26%</td>
</tr>
<tr>
<td>£500,000-£999,999</td>
<td>44%</td>
<td>9%</td>
<td>18%</td>
<td>29%</td>
</tr>
<tr>
<td>£1m-£5m</td>
<td>28%</td>
<td>9%</td>
<td>18%</td>
<td>45%</td>
</tr>
<tr>
<td>£5m+</td>
<td>17%</td>
<td>6%</td>
<td>14%</td>
<td>63%</td>
</tr>
<tr>
<td>All (unweighted)</td>
<td>47%</td>
<td>9%</td>
<td>13%</td>
<td>31%</td>
</tr>
</tbody>
</table>
While this size-related variation is to be expected, it is interesting to note that a substantial minority of the relatively smaller firms in this survey are also actively recruiting new staff. For example, more than a quarter of firms in the £250,000 to £499,999 band (26%) report that they have taken on several employees in this period⁵.

We did not find much evidence of strong sectoral variations in patterns of recruitment (Table 2). SMEs in the Hotels & Restaurants sector reported the highest figures, with 75% of respondents taking on at least one new employee and 55% recruiting several employees in the period. Manufacturing SMEs also report relatively high levels of employee recruitment, with 63% taking on at least one new employee. Recruitment activity can sometimes be interpreted as an indicator of the performance of firms. However, these above average figures may also reflect sector-specific factors, such as seasonal recruitment, which can contribute to higher rates of staff turnover⁶.

Table 2: Firms who have taken on new employees in the last two years, by sector

<table>
<thead>
<tr>
<th>Sector</th>
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<th>One (not first)</th>
<th>Several</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry, Fisheries</td>
<td>54%</td>
<td>8%</td>
<td>17%</td>
<td>21%</td>
</tr>
<tr>
<td>Business Services</td>
<td>51%</td>
<td>6%</td>
<td>11%</td>
<td>31%</td>
</tr>
<tr>
<td>Construction</td>
<td>49%</td>
<td>8%</td>
<td>18%</td>
<td>25%</td>
</tr>
<tr>
<td>Health, Education, Leisure, Other</td>
<td>46%</td>
<td>8%</td>
<td>11%</td>
<td>35%</td>
</tr>
<tr>
<td>Hotels &amp; Restaurants</td>
<td>25%</td>
<td>5%</td>
<td>15%</td>
<td>55%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>37%</td>
<td>15%</td>
<td>12%</td>
<td>36%</td>
</tr>
<tr>
<td>Retail</td>
<td>54%</td>
<td>9%</td>
<td>13%</td>
<td>24%</td>
</tr>
<tr>
<td>Transport, Storage &amp; Communication</td>
<td>51%</td>
<td>10%</td>
<td>14%</td>
<td>25%</td>
</tr>
<tr>
<td>Wholesale</td>
<td>54%</td>
<td>12%</td>
<td>10%</td>
<td>24%</td>
</tr>
<tr>
<td>All (unweighted)</td>
<td>47%</td>
<td>9%</td>
<td>13%</td>
<td>31%</td>
</tr>
</tbody>
</table>

We also examined responses to this question from businesses located in different parts of the UK but there was little evidence of strong regional variation. The proportion of respondents from the North East of England who had not taken on any new employees (63%) was somewhat higher than the average, but this may in part reflect the relatively small sub-sample of firms in this region.

Functions and tasks of new employees

Of those who recruited new staff (53%), almost half had taken on people to undertake core manufacturing or service delivery functions (47%). The next most commonly-reported functions in recruitment terms were marketing and customer services (33%) and accounting, financial management or payroll (15%) (Chart 2). Perhaps unsurprisingly, Manufacturing SMEs reported the highest figures for ‘manufacturing and service delivery’ (67%), closely followed by firms engaged in Agriculture, Forestry and Fishing (64%). In a similar way, Hotels and Restaurants had the highest figures for ‘marketing and customer service’ (48%), though SMEs in the Wholesale sector were also actively recruiting in this area (46%) (Table 3).

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⁵ There is some support for these size-related findings in the recent Barclays Job Creation Survey 2013, which is based on a sample of over 700 UK businesses. The survey found that 71% of mid-size businesses (turnover range: £5m up to £100m) intended to create jobs this year but only 48% of small businesses (turnover range: up to £5m) reported that they were creating jobs in the same period. The survey also found that the majority (79%) of businesses were not planning any job losses within the next 12 months. Barclays Job Creation Survey 2013 (15th April 2013). Report summary available at: http://www.newsroom.barclays.co.uk/Press-releases/

⁶ For more information on the performance of SMEs in these sectors, please refer to Chart 15 and Table 12.
In order to explore the question of whether businesses are content with not hiring new staff, or frustrated in their desire to grow, we cross-tabulated the employment question with our Entrepreneurial Index (EI) (Table 4). This shows that 65% of the firms that rate themselves as the most entrepreneurial (i.e. those with EI scores of 8-10) have recruited at least one new employee in the period, compared to just 30% those that see themselves as the least entrepreneurial (EI scores of 1-3). In addition, a much higher proportion of firms in the more entrepreneurial group have taken on several new staff (42%) compared to those with the lowest EI scores (16%). These findings suggest that the more growth- and innovation-oriented SMEs are also much more active in recruitment terms.
Table 4: Firms who have taken on new employees in the last two years, by entrepreneurial index

<table>
<thead>
<tr>
<th></th>
<th>None</th>
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<th>One (not first)</th>
<th>Several</th>
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<td>1-3</td>
<td>70%</td>
<td>5%</td>
<td>9%</td>
<td>16%</td>
</tr>
<tr>
<td>4-7</td>
<td>48%</td>
<td>10%</td>
<td>13%</td>
<td>30%</td>
</tr>
<tr>
<td>8-10</td>
<td>35%</td>
<td>8%</td>
<td>15%</td>
<td>42%</td>
</tr>
<tr>
<td>All (unweighted)</td>
<td>47%</td>
<td>9%</td>
<td>13%</td>
<td>31%</td>
</tr>
</tbody>
</table>

Reasons for employing or not employing new staff

We asked our online respondents about the reasons why they had either recruited new staff, or had not done so over the last two years. The findings, which are based on multiple responses to the question, reveal that a single SME may be recruiting new staff to address a number of different business-related issues. The main reason for recruiting, reported by more than half of these respondents (59%), was to replace an employee who had left the business (Chart 3). As noted earlier, it is important to recognise that while these new posts do create much-needed jobs, they are not always an indicator of firm-level growth. In our quarterly employment performance section, most SMEs report that their overall levels of employment are unchanged compared to the previous year (Table 10). However, it is notable that almost half of this sub-group of respondents (48%) had recruited in order to cope with increased workload. Several responses from the ‘other’ category could arguably be added to this figure (e.g. ‘expansion of the business’, ‘to open up new ventures’, to build strength and versatility into the board’ and ‘to provide resource of an aggressive and positive service and sales platform expansion’. In combination, these responses are a positive indication that firms are both actively seeking and responding to demand-led growth.

Chart 3: Reasons for taking on new employees (online respondents only)

The main reasons given by those who had not recruited new employees in this period were a lack of market demand or orders (43%), high cost of employing staff (24%) and concerns over employment legislation and ‘red tape’ (19%) (Chart 4). Amongst ‘other reasons’ given, the most common was that no additional staff were required. When analysing these responses, it is difficult to distinguish between firms that are content to operate at their current level of activity (i.e. without extra staff), and those that are seeking to grow, and where lack of market demand is therefore seen as problematic for the business. The verbatim comments included a few instances of the latter, such as ‘lack of

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7 This sub-sample comprised 199 online respondents, of which 81 had recruited new employees in the last two years and 118 who had not done so in this period.
work means we have laid off people’ and ‘not enough work to warrant it’. However, the comments of several fell into the former category, such as ‘growing old so business being run down’, ‘keep overheads low’ and ‘I am happy as a one man band’.

Chart 4: Reasons for not taking on new employees (online respondents only)

Recent trends in outsourcing

Outsourcing, or the contracting-out of core functions to third parties, is a long-established feature of large firms and public sector bodies, with smaller firms generally being seen as second or third tier suppliers, rather than being examined in their own right. However, there is also a growing literature on the outsourcing decisions made by SMEs, including their potential costs and benefits. This is reflected on the ground in the form of specialist providers, who in areas ranging from research and development to ‘back-office’ services such as accounting and IT support. In this survey, we wanted to explore recent trends in SME outsourcing. We began by asking respondents whether they had contracted out services or employed agency workers for any tasks or functions in the last two years. This produced what might appear a surprisingly low response, with almost four out of five respondents (79%) reporting that they had not engaged in either activity (Chart 5). Just over one in ten respondents (12%) had done so more than once, while for the remainder (9%) there had only been a single case of outsourcing in this period.

8 The issues have been theorised recently from a large firm perspective in: Chanson, G. and Quélin, B.V. (2013) ‘Decentralization and contracting out: a new pattern for internal and external boundaries of the firm.’ European Management Journal, in press.


10 One plausible explanation is that while larger firms often make routine use of outsourcing in order to grow without increasing headcount, smaller firms are often the recipients of outsourcing business and more likely to see such activity as a collaboration, often involving other local firms.
There was a fairly distinct relationship between size of firm and the extent of outsourcing activity (Table 5). For example, while only 13% of firms in the less than £100,000 turnover band reported that they had engaged in outsourcing, the proportion rose to 33% for those in the largest (£5 million+) size band. There were also differences in the levels of contracting out and the employment of agency workers between sectors. The highest figures were found amongst Construction sector SMEs, where more than a third of firms engaged in this activity (36%), including 22% of respondents who reported ‘several’ instances (Table 6).

Table 5: Use of contracted out services and/or agency workers, by turnover

<table>
<thead>
<tr>
<th>Turnover</th>
<th>None</th>
<th>One (first)</th>
<th>One (not first)</th>
<th>Several</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than £100,000</td>
<td>87%</td>
<td>4%</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>£100,000-£249,999</td>
<td>82%</td>
<td>5%</td>
<td>8%</td>
<td>5%</td>
</tr>
<tr>
<td>£250,000-£499,999</td>
<td>88%</td>
<td>2%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>£500,000-£999,999</td>
<td>73%</td>
<td>7%</td>
<td>7%</td>
<td>13%</td>
</tr>
<tr>
<td>£1m-£5m</td>
<td>74%</td>
<td>4%</td>
<td>3%</td>
<td>19%</td>
</tr>
<tr>
<td>£5m+</td>
<td>67%</td>
<td>4%</td>
<td>10%</td>
<td>19%</td>
</tr>
<tr>
<td>All (unweighted)</td>
<td>79%</td>
<td>4%</td>
<td>5%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Table 6: Use of contracted out services and/or agency workers, by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>None</th>
<th>One (first)</th>
<th>One (not first)</th>
<th>Several</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry, Fisheries</td>
<td>79%</td>
<td>8%</td>
<td>0%</td>
<td>13%</td>
</tr>
<tr>
<td>Business Services</td>
<td>75%</td>
<td>2%</td>
<td>9%</td>
<td>14%</td>
</tr>
<tr>
<td>Construction</td>
<td>64%</td>
<td>8%</td>
<td>6%</td>
<td>22%</td>
</tr>
<tr>
<td>Health, Education, Leisure, Other</td>
<td>82%</td>
<td>3%</td>
<td>3%</td>
<td>12%</td>
</tr>
<tr>
<td>Hotels &amp; Restaurants</td>
<td>88%</td>
<td>1%</td>
<td>4%</td>
<td>7%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>79%</td>
<td>4%</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>Retail</td>
<td>86%</td>
<td>4%</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>Transport, Storage &amp; Communication</td>
<td>87%</td>
<td>3%</td>
<td>0%</td>
<td>10%</td>
</tr>
<tr>
<td>Wholesale</td>
<td>81%</td>
<td>6%</td>
<td>5%</td>
<td>8%</td>
</tr>
<tr>
<td>All (unweighted)</td>
<td>79%</td>
<td>4%</td>
<td>5%</td>
<td>12%</td>
</tr>
</tbody>
</table>
Outsourced tasks and functions

Though the breakdown of the figures for outsourced activities are based on a relatively small sub-sample (224 firms), they provide an interesting contrast with the equivalent findings for new employees, which were discussed previously (Chart 2). Manufacturing and service delivery was the most commonly reported function in the case of contracted-out services and agency workers, being reported by almost half (46%) of these respondents (Chart 6). However, while this figure is very similar to that recorded for new employees (47%), the patterns of outsourcing were more varied for the other main tasks and functions. A higher proportion of respondents had outsourced Accounting, Financial Management or Payroll (21%), and Information Technology and/or Website (20%), as compared to those who had taken on new staff (i.e. 15% and 11% respectively) (Chart 2). By contrast, the proportions of firms outsourcing Marketing and/or Customer Services (15%) and Recruitment and other Human resources (6%) were lower than for those who had recruited new employees to take on those roles (i.e. 33% and 9% respectively) (Chart 2).

We also asked those respondents who had contracted out services or used agency staff about the location of their contractor(s). Responses to this question suggest that outsourcing by SMEs is overwhelmingly local, with 82% reporting that their contractors were located in the same city or region, 21% and only 5% identifying contractors based outside the UK (Table 7).11

Table 7: Location of outsourcing contractors

<table>
<thead>
<tr>
<th></th>
<th>Your city or local region</th>
<th>Another UK region</th>
<th>America</th>
<th>India</th>
<th>Other country within EU</th>
<th>Other country outside EU</th>
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</thead>
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<td>Less than £100,000</td>
<td>78%</td>
<td>32%</td>
<td>3%</td>
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<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>£100,000-£249,999</td>
<td>74%</td>
<td>22%</td>
<td>0%</td>
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<td>0%</td>
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<td>£250,000-£499,999</td>
<td>93%</td>
<td>27%</td>
<td>7%</td>
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<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>£500,000-£999,999</td>
<td>83%</td>
<td>14%</td>
<td>3%</td>
<td>3%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>£1m-£5m</td>
<td>81%</td>
<td>16%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>£5m+</td>
<td>85%</td>
<td>20%</td>
<td>4%</td>
<td>0%</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>All (unweighted)</td>
<td>82%</td>
<td>21%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
</tr>
</tbody>
</table>

11 These geographical differences reinforce the view that outsourcing activity, particularly in its international forms, has been more commonly associated with large businesses.
Employ or outsource?

We consulted our online respondents in order to probe the reasons behind the decision of SMEs to employ or to outsource these vital tasks and functions. This revealed a range of reasons, which are summarised below. Flexibility proved to be by far the most important reason for SMEs to engage in outsourcing, being identified as the main reason by 40% of these respondents (Chart 7).

Chart 7: Main reason for contracting out or employing agency staff

![Chart showing reasons for contracting out or employing agency staff]

More flexible: 40%
Lower cost: 15%
Higher quality: 12%
To get qualified staff / staff with experience/specialist skills: 9%
More reliable: 7%
Short staffed / emergency cover: 5%
Other: 5%
Temporary basis eg For a particular project: 4%
Don’t know: 2%
Seasonal staff: 1%

We also checked for evidence of a relationship between the amount of new jobs created and of outsourcing activity. The analysis is not conclusive, but the evidence suggests that firms that are active in creating new jobs are also more active in outsourcing particular activities, and vice versa.

The following verbatim comments provide some additional context, which helps to explain these often complex choices. It was clear from the responses that several factors could be involved in a single outsourcing decision. For example, the ‘lower cost’ factor can involve both the continuing costs of employing staff and the initial capital investment that would be required in order to get ‘up to speed’ in a particular task or function. It might also be combined with a degree of risk-reduction, such as where the skills or capabilities of potential employees are difficult to assess in advance:

[We] would have had to upgrade hardware and software to comply with Government Regulations (Real Time Interface for Payroll), as well as procure and train in new software. [It] seemed cheaper in both the short and long term to outsource the service.

Contracting out was because we could not afford the additional investment required for machinery to do the task. Employing agency workers was on a temporary to permanent basis to assess whether they met our requirements with less risk than employing them directly (i.e. without [having] experienced their demonstrated skills/techniques).

---

12 A cross-tabulation of the employment and outsourcing data indicated that 21% of the total had taken on employees but had not engaged in outsourcing. Only a small proportion of the firms who had not taken on any new employees in the last two years had simultaneously engaged in outsourcing (12%), and an even smaller proportion (5%) had taken on several contractors or agency staff. By contrast, more than a quarter (29%) of the firms who had taken on several staff had also outsourced some activities in the same period. Perhaps more striking is that most of the firms in this category (23%) had also taken on several contractors or agency staff.
Another common theme in outsourcing decisions was the need to obtain specialist skills or knowledge, particularly where these would be difficult to develop internally, or where they would not be required by the business on a regular basis:

*Certain research projects benefit from additional in-country research performed by people with experience of buyer and provider history and behaviour in that country. The combination, of local language, specific market know-how, and the fact that these were temporary assignments meant that a sub-contract approach was the only real option.*

*[I have a] personal lack of knowledge, and to a lesser extent interest, in accounting, VAT and self-assessment tax returns etc. It would involve me investing an inordinate amount of time to keep up to speed - I would rather use specialists who use the system day-in, day-out.*

Four closely-related factors appeared particularly important in those instances where firms had decided to keep particular tasks and functions in-house. As the following quotations indicate, their rationales involved: managerial control over the activity; quality and reputation; organisational culture and staff commitment; and the need to protect proprietary knowledge.

*[We are a] small business and run a tight ship. [We] have a good reputation for quality and reliability within the industry and wouldn't like to make decisions that may compromise the good working relationship we have with a number of new, repeat, or recommended customers. Don't wish to risk loss of control. May seem small minded to some, but it's worked for me for eight years.*

*We invest in our employees with training and product knowledge. This is not sensible for agency [staff, who are] non-committed individuals.*

*[We offer] long-term continuity of service from known quantity. We are a people service business in B2B and clients want to know the majority of people involved in projects. From an internal perspective there is a risk / concern at giving up information or control to non-employees. IT is outsourced and always has been, but accounting is the Chief Financial Officer’s job. Admin[istration] is too highly linked to client service to outsource confidently ...*

Lastly, it is worth noting that SME owners and managers are also re-assessing their positions on employment and contracting out in response to a changing business environment and as the needs of their own firm changes over time:

*Initially service delivery was contracted out to help manage extreme peaks and troughs in demand. Now the business is bigger we are able to smooth these ourselves and so we don’t outsource any service delivery. We [continue to] outsource human resources, web programming and graphic design as these skills don’t exist in-house and we only need them occasionally.*
Conclusions

This quarter’s special topic provides some encouraging evidence on recent employment trends amongst SMEs. More than half of respondents (53%) reporting that they have taken on at least one new member of staff in the last two years, and while many of these new employees may have been replacements rather than net additions to the firm’s payroll, each of them represents a new opportunity for the person involved. Evidence from our online respondents suggests that much of this recruitment activity can be attributed to greater demand for firms’ products and services, which has resulted in increased workloads. Another positive finding, from the perspective of the UK government’s growth agenda, and for economic development policies in the nations and regions, is that relatively smaller firms have also been taking on several new employees during this period. The overall figures for the contracting out of services and employment of agency workers are somewhat lower than expected and in most cases it was highly localised. However, it seems likely that the scope for outsourcing of certain activities, including many ‘back office’ functions, is likely to increase due to technological innovations such as cloud computing\textsuperscript{13}. SME owners and managers have difficult and important choices to make between outsourcing particular activities and keeping the work in-house. There is complex mix of factors involved in these decisions, and the case is likely to alter over time in response to changing circumstances.

\textsuperscript{13} See the recent special topic report on information technologies and cloud computing in the Quarter 1, 2013 edition of The Quarterly Survey of Small Business in Britain. Available at: www.open.ac.uk/quarterly-surveys
Problems

We have again seen remarkably little change in the ‘top’ business problem reported by SME owners and managers. The difficult economic climate, along with the associated negative impact on demand, remains by far the most commonly reported problem. Cashflow, payments and debtors remains the second most commonly cited problem, while government regulations retains its third place overall. There are no strong variations by firm size, sector or region.

Economic climate or demand

The economic climate or demand remains at the top of the list of most common problems facing UK SMEs, with more than a third of respondents reporting this as the main problem for their business (39%) (Chart 8). This figure is identical to that recorded in the two preceding quarters and has shown little variation over the last 12 months (i.e. 42% in Q3 2012 and 40% in Q2 2012). It has also remained a long way ahead of the second ranked problem in our list (i.e. 23 percentage points). The percentages are also remarkably consistent across all size bands (Table 8).

Chart 8: Proportion of firms indicating that each problem is the top one facing their business at the moment

Cashflow, payments or debtors

This is the sixth successive quarter when ‘cashflow, payments or debtors’ has been the second most commonly reported problem (16%), a slightly higher percentage to that recorded in our previous report (15%). SMEs engaged in construction (23%) and agriculture, forestry and fisheries (21%), were most likely to report it as their main problem on this occasion.
Government regulations

Government regulations remains the third most commonly identified ‘top’ problem for UK SMEs (11%), up slightly (i.e. by two percentage points) on the previous quarter. In this survey, respondents from agriculture, forestry and fisheries (29%) most frequently reported that Government regulations are currently their main business problem, though this result is based on a relatively small sub-sample. The indirect costs associated with new legislation can also become an important issue for SMEs operating in particular sectors. For example, one of our online respondents, whose firm provides private rental properties, comments on the indirect impact of recent housing benefits legislation on the profitability of this business, ‘The rents paid for benefit tenants are being reduced by government. My properties are in an area of moderately high unemployment, so many of the tenants are on benefits. The value of the investment in such a situation drops as the house prices reflect the achievable rental values. You may think that I should sell, but with a large (and largely artificial) capital gain over the 75 years since the properties were built by the company, I would not derive anything like the income from the proceeds of a sale of the business.’

The total tax burden

The percentage of respondents reporting that the total tax burden is the top problem facing their business remains at 6%, placing it in equal fifth place. Overall levels of taxation seem to be more of a problem for firms in the hotels and restaurants sector (13%), a figure that is unchanged from the previous quarter. More specific taxation changes can also be an issue for SMEs. For example, two of our online respondents refer to the tax treatment of company vehicles as creating a ‘major’ problem for their business. The first highlights changes implemented at a national level: ‘Taxation, particularly in the treatment of vehicles, with government finding ways of making less and less tax deductible’. The second refers to more localised changes in the charging regime for vehicles driving in central London: ‘The final straw was the reinstatement of the London Congestion Charge for my LPG vehicle which increased my costs by about 70p per delivery.’

Inflation or cost of inputs

Inflation and the costs associated with running a SME remains in equal fifth place for a second quarter (6%) alongside the total tax burden. On a sectoral basis, this problem was again the most pressing for hotels and restaurants (12%). By contrast, it was only identified by a very small percentage of firms in the construction sector (2%). The cost of inputs can be a particular issue due to supply chain pressures. For example, an online respondent running an independent public house identifies the relatively high cost of buying-in beer as a ‘major’ problem as the business seeks to compete with larger chains of ‘tied’ pubs: ‘High cost of beer compared to non-tied pubs, approximately 70% higher, therefore making margins very tight.’

Interest rates or access to finance

This was reported as a ‘top problem’ by a slightly lower proportion of firms compared to the previous quarter (4%). While firms with more than 50 employees report a somewhat higher figure than for the sample as a whole (7%), these figures do not suggest a strong size-related pattern (Table 8). The SME Finance Monitor provides further information on issues related to access to finance14.

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14 SME Finance Monitor. Available at: http://www.sme-finance-monitor.co.uk/
Lack of time or capacity and lack of skilled employees

As in the previous quarter, very few firms identified either of these as their top business problem. However, it is worth noting that both matching capacity requirements and estimating demand for skilled staff can be very difficult management challenges. This is illustrated by one of our online respondents who commented that a major problem for the business is in, ‘deciding when to increase staff numbers if workload maintains current level’. The special topic section in this issue of the Quarterly Survey provides more detail on issues related to employment and outsourcing of business functions. Education, training and skills development were also examined in a recent Quarterly Survey report\textsuperscript{15}.

Table 8: Proportion indicating each problem is the top one, by number of employees

<table>
<thead>
<tr>
<th>Problem</th>
<th>0</th>
<th>1-4</th>
<th>5-9</th>
<th>10-19</th>
<th>20-49</th>
<th>50-250</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic climate or demand</td>
<td>39%</td>
<td>43%</td>
<td>34%</td>
<td>35%</td>
<td>41%</td>
<td>41%</td>
<td>39%</td>
</tr>
<tr>
<td>Cashflow, payment or debtors</td>
<td>19%</td>
<td>12%</td>
<td>17%</td>
<td>23%</td>
<td>14%</td>
<td>13%</td>
<td>16%</td>
</tr>
<tr>
<td>Government regulations</td>
<td>13%</td>
<td>11%</td>
<td>15%</td>
<td>8%</td>
<td>10%</td>
<td>10%</td>
<td>11%</td>
</tr>
<tr>
<td>Total tax burden</td>
<td>6%</td>
<td>8%</td>
<td>7%</td>
<td>7%</td>
<td>6%</td>
<td>2%</td>
<td>6%</td>
</tr>
<tr>
<td>Inflation or cost of inputs, etc</td>
<td>9%</td>
<td>3%</td>
<td>7%</td>
<td>4%</td>
<td>4%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Lack of skilled employees</td>
<td>0%</td>
<td>3%</td>
<td>6%</td>
<td>5%</td>
<td>9%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Interest rates or access to finance</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
<td>5%</td>
<td>3%</td>
<td>7%</td>
<td>4%</td>
</tr>
<tr>
<td>Lack of time / capacity</td>
<td>6%</td>
<td>8%</td>
<td>3%</td>
<td>4%</td>
<td>3%</td>
<td>3%</td>
<td>4%</td>
</tr>
<tr>
<td>None / No problems</td>
<td>7%</td>
<td>10%</td>
<td>8%</td>
<td>9%</td>
<td>9%</td>
<td>11%</td>
<td>9%</td>
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<tr>
<td>Sample size</td>
<td>90</td>
<td>238</td>
<td>166</td>
<td>212</td>
<td>140</td>
<td>228</td>
<td>1076</td>
</tr>
</tbody>
</table>

\textsuperscript{15} Quarterly Survey of Small Business in Britain, Q3 2012. Special topic: education, training and skills development. Available at: www.open.ac.uk/quarterly-survey
Chart 9: Mainstream businesses in England and Wales, starts closures & net change, (thousands), four quarter moving averages, Source: Business Economics, Barclays

Chart 9 shows Barclays' estimates of the number of 'mainstream' businesses, based on the number of business accounts held with them and an estimate of their market share. The figures suggest that there have been net increases in the stock of businesses in every quarter for the last five years. The rate of business starts in this period has been consistently higher than that for business closures. Though the stock of businesses continued to grow strongly during 2012, there has been a marked tailing off in the rate of business starts and of closures in this period. The latest ONS labour market statistics, published in June 2013, also point to a slow-down in the previous growth trend in self-employment. Between November 2012 to January 2013 and February to April 2013, the ONS estimates the number of self-employed people in the UK increased by 21,000 to reach 4.20 million (n.b. seasonally adjusted figures).16

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Chart 10 shows the Barclays Small Business Activity Index (‘SBA Index’), derived from the banking activity of over 200,000 small firms\textsuperscript{17}. The SBA Index has fluctuated over the last 12 months while the GDP growth rate has remained relatively stable over the same period. For the first quarter of 2013, the SBA Index fell from 0 to -10, while the change in GDP compared to the same quarter in the previous year rose from 0.2\% to 0.6\%.

\textsuperscript{17} Data in this section relates to Q1 2013. Sources: SBA Index supplied courtesy of the Business Economics & Research Team, Barclays. UK GDP change data obtained from the Office for National Statistics (ONS), available at: www.ons.gov.uk, IHYR, GDP, quarter on quarter of previous year, CVM. Second Estimate of GDP Q1 2013 (23\textsuperscript{rd} May 2013). GDP estimates are revised by the ONS on a regular basis. Chart 9 includes revisions made following publication of the previous Quarterly Survey (2013 Q1) report.
Performance

The latest results suggest a slight weakening of the positive sales performance reported in the first quarter of 2013. Employment performance has also declined slightly, producing a marginally negative net balance. Behind these overall figures, we can see some marked variations by firm size. Relatively larger firms continue to report much stronger sales and employment performances than their smaller counterparts.

Sales performance: overview

The latest results indicate a decline in net sales balances (+5% compared to +9% for the previous quarter), though the overall balance remains positive. Though there have been some small changes in the underlying figures in recent surveys, the picture provided by this statistic remains quite stable when viewed at this aggregate level (Chart 11 and Table 9).

Chart 11: Percentage balance of respondents reporting an increase in sales over past year, compared with change in real GDP

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18 Enlargements and consequent changes in composition of the sample led to breaks in the series in 2002, 2008 and earlier in 2011. Details can be found in Vol 18(2), Vol 24(4) and Vol 27(3) of this survey. GDP change data is from www.ons.gov.uk, IHYR (pre-1988 calculated as change in YBEZ), GDP, quarter on quarter of previous year, CVM. Second Estimate of GDP Q1 2013 (23rd May 2013). GDP estimates are revised by the ONS on a regular basis.
Table 9: Change over past year in sales turnover, compared with previous survey (weighted figures)

<table>
<thead>
<tr>
<th></th>
<th>Up</th>
<th>Same</th>
<th>Down</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q2 2013 report: (comparing 2013 Q1 on 2012 Q1)</td>
<td>35%</td>
<td>36%</td>
<td>29%</td>
<td>+5%</td>
</tr>
<tr>
<td>Q1 2013 report: (comparing 2012 Q4 on 2011 Q4)</td>
<td>37%</td>
<td>36%</td>
<td>28%</td>
<td>+9%</td>
</tr>
<tr>
<td>Q4 2012 report: (comparing 2012 Q3 on 2011 Q3)</td>
<td>32%</td>
<td>38%</td>
<td>30%</td>
<td>+2%</td>
</tr>
</tbody>
</table>

Employment performance: overview

The overall net employment balance is slightly negative (-1%), reversing the move into positive territory (+1%) in the previous quarter. However, though the proportion of respondents reporting an increase in employment (17%) is now lower than those reporting a decline (18%), the underlying changes are marginal. It is also important to note that almost two thirds of SMEs (65%) report no net change in their levels of employment over the past year (Table 10).

Table 10: Change over past year in employment, compared with previous survey (weighted figures)

<table>
<thead>
<tr>
<th></th>
<th>Up</th>
<th>Same</th>
<th>Down</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q2 2013 report: (comparing 2013 Q1 on 2012 Q1)</td>
<td>17%</td>
<td>65%</td>
<td>18%</td>
<td>-1%</td>
</tr>
<tr>
<td>Q1 2013 report: (comparing 20Q4 on 2011 Q4)</td>
<td>17%</td>
<td>66%</td>
<td>16%</td>
<td>+1%</td>
</tr>
<tr>
<td>Q4 2012 report: (comparing 2012 Q3 on 2011 Q3)</td>
<td>16%</td>
<td>65%</td>
<td>19%</td>
<td>-3%</td>
</tr>
</tbody>
</table>

Chart 12: Percentage balance of respondents reporting an increase in employment over past year, compared with change in jobs

Note: in Table 9, the balance figure is the result of rounding in the calculations

In the previous report, we noted that ONS Labour Market Statistics – a broad measure of change in workforce jobs – had been revised (April 2013) and that the latest figures showed that this gap has narrowed somewhat in the most recent quarter. The latest employment balance suggests a continuation of the fairly stable picture on SME employment over recent quarters (Chart 12).

**Other SME Surveys**

This section reviews other SME research that has been conducted during the period covered in this report. In most cases, they paint a broadly similar picture to our own survey, with indications of modest improvements in business performance towards the end of 2012, tempered by some sectoral and geographic variations. However, it is also worth bearing in mind that summary statistics of this kind necessarily mask differences in the experiences of individual firms.

As we have already noted in the Business Stock and Activity Index section, the latest Barclays Small Business Activity (SBA) Index, which is derived from the banking activity of over 200,000 small firms is -10 for Q1 2013, down from 0 (zero) in the previous quarter (Chart 9). The Federation of Small Businesses’ Voice of Small Business Index for the second quarter of 2013 reported that small firms’ confidence levels had reached 15.9, a 9.6 point improvement on the Q1 2013 index figure of 6.3 and a three-year high. Financial services firms report the highest confidence levels and the FSB reports that 15% of firms plan to increase exports over the next three months. The balance of firms expecting to increase staff levels is also up at 4.8%, compared to just 0.8% in Q2 2012. The British Chambers of Commerce (BCC) Quarterly Economic Survey reported that most key balances in its most recent report were stronger than in Q1 2013, though they are still below the pre-recession levels seen in 2007. For example, the BCC’s national manufacturing employment balance rose eight points to +19%, the best level reported since Q4 2010. The BCC’s balance of manufacturing firms planning to increase investment in plant and machinery rose a further 9 points to +23%, the equal best level since Q3 2007. By contrast, the investment balance for services firms fell by two points to +7%. The CBI Quarterly SME Trends Survey was unavailable at the time of writing but the CBI Manufacturers Survey, published on 20th June 2013 was somewhat more pessimistic than other surveys, reporting that manufacturing SMEs struggled to maintain their export orders, which had reached their lowest levels since January 2010. However, the CBI respondents did expect output to increase in the next three months.

The English Business Survey is still classed as ‘experimental official statistics’ and advises against comparisons across months. The survey uses balance statistics but they are not directly comparable to the other data reported in this section, or to the findings of the other SME surveys reviewed in this section. For example, it is based on individual workplaces rather than firms (though as the latest EBS quarterly statistical bulletin points out, 97% of enterprises are based on a single workplace). In addition, the EBS comparisons are to the preceding quarter, rather than to the equivalent quarter in the previous year, and it excludes non-registered businesses.

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21 FSB Voice of Small Business Index, Q2 2013. Available at: http://www.fsb.org.uk/small-business-index
The EBS identifies that ‘[o]utput results were positive in April for England overall reaching the highest level since the survey began in October 2011.’ The proportion of workplaces in England reporting output being higher than it was three months earlier was 47% in April’s survey, with 14% reporting that output was lower, producing a net balance of +33%. As the EBS bulletin notes, this is a ‘sharp improvement’ on the balance for the previous month (+14%) and on that for the equivalent period in 2012 (+24%). As noted in our previous report, the EBS results for micro businesses, with 1 to 9 employees, are much weaker (+20%) and were the size band in which the highest proportion anticipated lower output in the next three months (18% of businesses).26 Overall employment balances in the EBS were also positive, the best results being for medium-sized firms being (+14%), followed by small businesses (+7%). These findings continue to support our own results, where both sales and employment balances have shown some improvement in this survey.

Performance: comparison across size bands

The UK’s smallest firms continue to report a worse performance than their relatively larger counterparts, whether this is measured in terms of turnover or employee numbers (Charts 13 and 14). Firms in the less than £100,000 band have fared particularly badly over this period and recorded a negative net sales balance of -9%. There was a much stronger performance by medium-sized firms, with the net sales balance for firms in the £5m+ range recovering to (+23% compared to +17% in the previous survey).

Chart 13: Percentage balance reporting an increase in sales over past year, by turnover size band

![Chart 13: Percentage balance reporting an increase in sales over past year, by turnover size band](image)

26 Ibid. p.6.
Size-related differences in sales performance are also reflected in our measure of employment performance, though the pattern is much less clear-cut (Table 11). Firms in the less than £100,000 band report the most negative employment balances, with 20% having reduced their average employment over the preceding 12 months and only 9% having increased it, creating a net balance of -11%. However, in this survey, they were closely matched by firms in the £500,000-£999,000 band (-10%). Employment balances were positive for firms with a turnover in excess of £1 million and the strongest performance is seen amongst firms in the £5m+ turnover band (+20%). These medium-sized firms also contained the highest proportion of respondents reporting an increase in average employment over the past year. In other words, more than a third (35%) of firms in this size band stated that they had increased average employment since the equivalent quarter in 2012.

Table 11: Percentage balances for average employment over past year by turnover size band

<table>
<thead>
<tr>
<th>Turnover Size Band</th>
<th>Up</th>
<th>Same</th>
<th>Down</th>
<th>Net Balance</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than £100,000</td>
<td>9%</td>
<td>71%</td>
<td>20%</td>
<td>-11%</td>
<td>276</td>
</tr>
<tr>
<td>£100,000-£249,999</td>
<td>8%</td>
<td>75%</td>
<td>17%</td>
<td>-8%</td>
<td>131</td>
</tr>
<tr>
<td>£250,000-£499,999</td>
<td>16%</td>
<td>68%</td>
<td>16%</td>
<td>+1%</td>
<td>129</td>
</tr>
<tr>
<td>£500,000-£999,999</td>
<td>15%</td>
<td>60%</td>
<td>25%</td>
<td>-10%</td>
<td>107</td>
</tr>
<tr>
<td>£1m-£5m</td>
<td>20%</td>
<td>64%</td>
<td>16%</td>
<td>+4%</td>
<td>262</td>
</tr>
<tr>
<td>£5m+</td>
<td>35%</td>
<td>51%</td>
<td>14%</td>
<td>+20%</td>
<td>168</td>
</tr>
<tr>
<td>All</td>
<td>17%</td>
<td>65%</td>
<td>18%</td>
<td>-1%</td>
<td>1076</td>
</tr>
</tbody>
</table>

Performance: comparison across sectors

There are further differences in the sectoral breakdown as compared to those for the previous quarter (Chart 15). The overall impression is of a levelling of the differences between sectors, with previous strong performers doing less well and weaker ones improving. As noted on previous occasions, the results for certain sectors (e.g. agriculture, forestry and fisheries) need to be treated with caution due to the relatively small size of the relevant sub-sample. In terms of the larger sub-samples, the net sales balance for construction remains the most strongly positive by sector, a similar result to that recorded in the previous report (+12% compared to +13% in Q1 2013). The
Performance

performance of SMEs in the hotels and restaurants sector has declined (+8% compared to +20% previously), a result that is likely to reflect the seasonal factors operating in this sector.

Chart 15: Percentage balance of respondents reporting an increase in sales over past year, by sector

Analysis of the latest employment balances does not indicate that any industry sectors are performing strongly in terms of job creation (Table 12). Wholesale (+7%) and construction (+5%) appear to be the brightest sectors, despite the former’s negative sales balance. The positive sales performance recorded by hotels and restaurants (+8%), is not reflected in the sector’s employment performance, which remains negative (-8% compared to -4% in the previous quarter). There is a similar pattern for SMEs in health, education, leisure other (i.e. a +6% sales balance coupled with a -6% employment balance).

Table 12: Change over past year in sales and employment, by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Sales Turnover</th>
<th>Average Employment</th>
<th>Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry, Fisheries</td>
<td>+8%</td>
<td>0%</td>
<td>24</td>
</tr>
<tr>
<td>Business Services</td>
<td>+6%</td>
<td>0%</td>
<td>236</td>
</tr>
<tr>
<td>Construction</td>
<td>+12%</td>
<td>+5%</td>
<td>137</td>
</tr>
<tr>
<td>Health, Education, Leisure, Other</td>
<td>+6%</td>
<td>-6%</td>
<td>173</td>
</tr>
<tr>
<td>Hotels &amp; Restaurants</td>
<td>+8%</td>
<td>-8%</td>
<td>85</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>+1%</td>
<td>-1%</td>
<td>113</td>
</tr>
<tr>
<td>Retail</td>
<td>+6%</td>
<td>-2%</td>
<td>136</td>
</tr>
<tr>
<td>Transport, Storage &amp; Communication</td>
<td>-2%</td>
<td>-3%</td>
<td>63</td>
</tr>
<tr>
<td>Wholesale</td>
<td>-5%</td>
<td>+7%</td>
<td>109</td>
</tr>
<tr>
<td>All (weighted by sector)</td>
<td>+5%</td>
<td>-1%</td>
<td>1076</td>
</tr>
</tbody>
</table>
Performance: comparison across regions

This quarter has seen considerable variability in regional SME performances, as measured by the net sales and net employment balances of our respondents (Table 13).27 SMEs in Scotland (+17%), Northern Ireland (+14%) and the East Midlands (+14%) recorded the strongest positive net sales balances. The North East has seen the biggest reversal (-16% compared to +14% previously). The South East of England has also produced a negative balance on this occasion (-6% compared to +2% in Q1 2013), while the South West remains more buoyant (+10% as in the last quarter). The picture for employment by region is somewhat weaker than for sales performance. The East of England and Northern Ireland reported a combination of positive net sales balances and negative net employment balances. Elsewhere, the following nations and regions also reported negative net employment balances: North East (-16%), North West (-3%), South East (-4%).

Table 13: Change over past year in sales and employment, by region

<table>
<thead>
<tr>
<th>Region</th>
<th>Sales Turnover</th>
<th>Average Employment</th>
<th>Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>North East</td>
<td>-16%</td>
<td>-16%</td>
<td>38</td>
</tr>
<tr>
<td>North West</td>
<td>+1%</td>
<td>-3%</td>
<td>106</td>
</tr>
<tr>
<td>Yorkshire &amp; the Humber</td>
<td>+9%</td>
<td>+3%</td>
<td>79</td>
</tr>
<tr>
<td>East Midlands</td>
<td>+14%</td>
<td>+2%</td>
<td>91</td>
</tr>
<tr>
<td>West Midlands</td>
<td>+5%</td>
<td>+4%</td>
<td>75</td>
</tr>
<tr>
<td>East of England</td>
<td>+9%</td>
<td>-4%</td>
<td>105</td>
</tr>
<tr>
<td>London</td>
<td>+3%</td>
<td>+1%</td>
<td>157</td>
</tr>
<tr>
<td>South East</td>
<td>-6%</td>
<td>-5%</td>
<td>188</td>
</tr>
<tr>
<td>South West</td>
<td>+10%</td>
<td>+2%</td>
<td>99</td>
</tr>
<tr>
<td>Wales</td>
<td>+12%</td>
<td>+7%</td>
<td>43</td>
</tr>
<tr>
<td>Scotland</td>
<td>+17%</td>
<td>+5%</td>
<td>66</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>+14%</td>
<td>-11%</td>
<td>28</td>
</tr>
<tr>
<td>All (weighted by sector)</td>
<td>+5%</td>
<td>-1%</td>
<td>1076</td>
</tr>
</tbody>
</table>

27 Please note that the figures for Northern Ireland in this section should be treated with caution given the relatively small size of the relevant sub-sample.
SMEs are again optimistic about the future, as indicated by improvements in overall sales expectations in this quarter, though this is coupled with a slight decline in overall expectations for employment. In both cases, relatively larger firms remain more optimistic than their smaller counterparts. SMEs in the wholesale and transport and storage sectors report a more positive view about future sales this quarter, while manufacturing firms are less optimistic. Respondents in the North East of England report much lower sales and employment expectations than those in other areas, a result that seems to reflect their reported performance in this survey.

This quarter has seen a further improvement in SMEs’ expectations regarding their sales’ performance. This follows two quarters in which the prospects figures were largely unchanged. More than one third of firms (37%) expect their sales to rise in the period (up from 35% in the previous report), less than a quarter of firms (22%) expect them to fall (unchanged from last time). The net balance for this quarter is therefore up by three percentage points (15%) (Table 14).

Table 14: Expected change in sales turnover compared with same quarter last year (weighted figures)

<table>
<thead>
<tr>
<th></th>
<th>Up</th>
<th>Same</th>
<th>Down</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q2 2013 report:</td>
<td>37%</td>
<td>40%</td>
<td>22%</td>
<td>+15%</td>
</tr>
<tr>
<td>(comparing 2013 Q2 on 2012 Q2)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1 2013 report:</td>
<td>35%</td>
<td>42%</td>
<td>22%</td>
<td>+13%</td>
</tr>
<tr>
<td>(comparing 2013 Q1 on 2012 Q1)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q4 2012 report:</td>
<td>33%</td>
<td>42%</td>
<td>25%</td>
<td>+8%</td>
</tr>
<tr>
<td>(comparing 2012 Q4 on 2011 Q4)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The first quarter has seen a modest decrease in the employment prospects figures. While the percentage of firms expecting average employment to increase is largely unchanged from the figures for the two preceding quarters, there has been a two percentage point increase in the proportion of firms expecting net employment to decline (14% compared to 12% previously). As a consequence, the net balance is slightly less positive (+2% compared to +4% previously) (Table 15), though expectations remain some way behind those for future changes in sales turnover.

Table 15: Expected change in average employment compared with same quarter last year (weighted figures)

<table>
<thead>
<tr>
<th></th>
<th>Up</th>
<th>Same</th>
<th>Down</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q2 2013 report:</td>
<td>17%</td>
<td>69%</td>
<td>14%</td>
<td>+2%</td>
</tr>
<tr>
<td>(comparing 2013 Q2 on 2012 Q2)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1 2013 report:</td>
<td>16%</td>
<td>72%</td>
<td>12%</td>
<td>+4%</td>
</tr>
<tr>
<td>(comparing 2013 Q1 on 2012 Q1)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q4 2012 report:</td>
<td>16%</td>
<td>69%</td>
<td>15%</td>
<td>+1%</td>
</tr>
<tr>
<td>(comparing 2012 Q4 on 2011 Q4)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In this survey, we also asked our online respondents about their expectations for investment in the quarter. Of this smaller sub-sample (total: 197 responses), just over a half (54%) expected no

Note: in Table 13 the net sales balance for Q3 2012 is the result of rounding in the calculations.

Note: in Table 15, the balance figure is the result of rounding in the calculations.
change, while 25% expected to increase investment and 21% expected it to fall in the period. This produced a positive net balance for investment expectations (+4%).

Prospects: comparison across size bands

Amongst the UK’s diverse SME population, medium-sized firms are much more optimistic about their prospects for sales growth in the next quarter compared to their relatively smaller counterparts. Firms with a turnover above £5 million have the strongest positive net sales balances (+33%), with a fairly consistent downwards trend for smaller size bands (Chart 16). Respondents in smaller firms tend to be less optimistic overall. However, on this occasion net sales balances are positive across the size range, including those with turnover of less than £100,000 (+1%).

Chart 16: Percentage balance expecting an increase in sales over past year by turnover size band

SME expectations regarding average employment are generally lower than those for sales turnover (Table 14 and Table 15). These differences are also apparent when the employment prospects figure is broken down by firm size (Chart 17). There is a clear distinction between a perceived lack of employment prospects amongst smaller firms and the more encouraging picture painted by relatively larger firms. On this occasion, firms with a turnover of more than £250,000 have moved to the positive side, albeit at with a very slim net employment balance (+1%), while those in the two smaller size bands have reported negative balances.
Prospects

This breakdown suggests considerable differences in the sentiments about the immediate future from SMEs located in different industry sectors (Chart 18 and Table 16). If we exclude agriculture, forestry and fisheries, there are still four sectors with changes of more than ten percentage points over the previous quarter. The net sales balance for hotels and restaurants is up by 20 percentage points (+19% compared to -1% in the previous report). Wholesale has seen a 15 percentage point rise (+26% compared to +11% in Q1 2013), while transport, storage and communication SMEs report increased optimism about future sales with an 15 percentage point rise (+19% compared to +4% previously). By contrast, manufacturing SMEs are somewhat less positive about their sales prospects (+17% compared to +32% in the last quarter).

Employment prospects are more muted, in comparison to anticipated sales. The most optimistic responses are from SMEs in wholesale (+8%), manufacturing (+7%) and business services (+6%). By contrast, there are slightly negative net employment balances for SMEs in the retail sector (-2%), hotels and restaurants (-2%) and health, education, leisure, other (-4%) (Table 16).

Prospects: comparison across sectors

See the Performance section of this report, where recent volatility has been identified as a possible result of the relatively small sub-sample for this sector giving rise to sampling-related differences.
Prospects: comparison across regions

As noted in previous reports, expectations for sales and employment tend to vary markedly by region (Table 17), with the figures often, but not always, approximating to those reported in the Performance section. Respondents in several regions are more optimistic about sales and employment prospects, as compared to the previous report. The main exception is the North East, where negative balances (-11% for sales and -16% for employment) tend to echo those recorded for performance (Table 12). Overall, firms in the East Midlands, Yorkshire and the Humber, Scotland and Wales are the most optimistic about their prospects. Firms in the South East of England are also relatively optimistic, despite the lower performance figures for this region (Table 12).
Table 17: Expected change current quarter over year in sales and employment by region

<table>
<thead>
<tr>
<th>Region</th>
<th>Sales Turnover</th>
<th>Average Employment</th>
<th>Sample</th>
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<td>+10%</td>
<td>91</td>
</tr>
<tr>
<td>West Midlands</td>
<td>+16%</td>
<td>+7%</td>
<td>75</td>
</tr>
<tr>
<td>East of England</td>
<td>+21%</td>
<td>-3%</td>
<td>105</td>
</tr>
<tr>
<td>London</td>
<td>+16%</td>
<td>+3%</td>
<td>156</td>
</tr>
<tr>
<td>South East</td>
<td>+12%</td>
<td>-2%</td>
<td>188</td>
</tr>
<tr>
<td>South West</td>
<td>+9%</td>
<td>0%</td>
<td>99</td>
</tr>
<tr>
<td>Wales</td>
<td>+21%</td>
<td>+9%</td>
<td>43</td>
</tr>
<tr>
<td>Scotland</td>
<td>+20%</td>
<td>0%</td>
<td>66</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>-4%</td>
<td>0%</td>
<td>28</td>
</tr>
<tr>
<td>All (weighted by sector)</td>
<td>+15%</td>
<td>+2%</td>
<td>1076</td>
</tr>
</tbody>
</table>
Entrepreneurial index

Larger firms tend to view themselves as more entrepreneurial. These self-reported measures also vary by region and sector. The most entrepreneurial firms report the best performance over the past year and are more optimistic about prospects for the current quarter.

Chart 19: “Entrepreneurial firms are more competitive, growth-minded and innovative than other firms. Where would you put your firm on a scale of 1 to 10?”

Respondents are asked to rate their firm on an entrepreneurial scale, where 1 is not at all entrepreneurial and 10 is extremely entrepreneurial. Entrepreneurial firms are defined as being more competitive, growth-minded and innovative than other firms. Firms which rate themselves as entrepreneurial tend to be larger than their non-entrepreneurial counterparts, perhaps reflecting their stronger growth-orientation. Business owners with an annual turnover of less than £100,000 rate themselves on average 5.4 on the entrepreneurial scale, while those with a turnover of more than £5 million rate themselves as 6.8 (Chart 19). These differences are relatively stable over time. For example, the equivalent figures in Quarter 2 2012 were 5.4 and 6.6. Firms which rate themselves higher on the entrepreneurial scale tend to report better sales performance and are more optimistic about their immediate sales prospects. In this survey, the ‘least entrepreneurial’ firms (those rating themselves from 1 to 3) have seen sales fall in the last year but expect a rise in most recent quarter, as compared to a year earlier (sales performance balance –9% and sales prospects balance +2%). By contrast, the ‘most entrepreneurial’ firms (those rating themselves from 8 to 10) have seen sales rise and expect the trend to continue (sales performance balance +21% and a sales prospects balance of +32%). There is a similar pattern for employment. Here, the ‘least entrepreneurial’ firms (those rating themselves from 1 to 3) have seen employment fall in the last year and do not expect it to rise in the most recent quarter, as compared to a year earlier (employment performance balance –11% and employment prospects balance -5%). This again contrasts sharply with the ‘most entrepreneurial’ firms (those rating themselves from 8 to 10), which have seen employment rise and expect this trend to continue (employment performance balance +9% and a employment prospects balance of +14%).
How the survey is carried out

This is the 115th survey completed since the series began in 1984. Firms that respond to the survey are drawn from a wide range of sources. They reflect the complexity and richness of business life in Britain today. It should be noted that the survey is not a panel, nor is it fully random. It continuously recruits new members to reflect the national distribution of small firms; yet it also retains long time respondents to gauge changes over time.

This is the final survey report in our series to include the regular Problems, Performance and Prospects sections. Further information on these important changes to the survey format is provided at the front of this report. Additional guidance will be included in the next survey report (Q3 2013) and on the Quarterly Survey web pages (www.open.ac.uk/quarterly-survey).

In this survey, our regular online respondents (owners and managers of small businesses who had previously volunteered to take part) were supplemented by telephone interviews of owners and other senior managers of small businesses, carried out by BDRC Continental\(^{31}\). The link to the online questionnaire was emailed to 1,256 regular respondents on 15\(^{th}\) April 2013 and a reminder email sent to non-respondents on 12\(^{nd}\) May 2013. In total, 199 of these regular participants responded. Telephone interviews were carried out in two waves. Between the 2nd and 12th April 2013, 439 telephone interviews were carried out. Between the 7th and 17th May 2013, a further 438 firms were interviewed. The total number of responses was therefore 1,076.

The telephone respondents do not include firms with a turnover below £50,000. Few of the online respondents have more than 50 employees. The telephone respondents include more firms established since 2006 than the regular online respondents. There are a higher proportion of telephone respondents in business services and manufacturing but lower proportions in health, education, leisure & other and hotels & restaurants. There are also this time slightly higher proportions in South East and East of England and a lower proportion in Scotland and Wales.

Following the well-established practice of the CBI in its Industrial Trends Survey\(^ {32}\), a summary statistic, the balance, is used to monitor the responses to key questions. The balance is the percentage of respondents replying ‘up’ minus the percentage replying ‘down’ (we ignore, for this purpose, the percentage replying ‘same’).

The key balances for the questions on performance and prospects are split by industrial sector and re-weighted according to the national sectoral SME distribution, using BIS (Department for Business, Innovation and Skills) estimates of total employment by firms with fewer than 250 employees. In earlier surveys results for previous years were re-weighted as estimates for those years became available. To avoid continuous revisions figures are now weighted by the latest figures available (currently 2012) and not revised. The aim of the weighting is to ensure that the results are as representative as possible of the business population in Britain (n.b. from 1995 to the second survey of 2011, results were weighted by the sectoral distribution of employment in firms with fewer than 50 employees. Between 1989 and 1995 results were weighted by the sectoral distribution of all VAT registered businesses and prior to 1989 they were unweighted). Other breakdowns by industrial sector, region and firm size and the tables on problems and in the special topic section use unweighted data and are not seasonally adjusted.

\(^{31}\) BDRC Business Omnibus, further details available at: http://www.continentalresearch.com/business-omnibus/

In tables by number of employees, we have adopted the BIS definition of a firm with no employees. This is where a self-employed sole proprietor or partners work on their own with no employees or where a limited company has a single employee director. Note that a firm with one sole proprietor and one employee is counted as a one employee firm, but a company with two employees is counted as a two employee firm.

The survey has reported in each issue on changes in sales and employment and on the ranking of most important problems experienced by small firms. Barclays Bank also provides its latest estimates of small business closures and starts, and their Small Business Activity Index, which are used as indicators of recent performance.

A full set of historical tables is available on request, and will continue to be available as a resource for researchers. For more information on the survey, please contact oubs-enterprise@open.ac.uk.
The history of the Quarterly Survey

As the survey embarks on a new phase, we have taken this opportunity to reproduce a short historical account, which is also available on our website: www.open.ac.uk/quarterly-survey

Policy recognition of the economic, political and social importance of small firms in Britain traces its roots back 40 years to the publication of the Bolton Report in 1971. Chaired by John Bolton, a successful and publicly-spirited industrialist, the Bolton Report also marks the conception of the Quarterly Survey of Small Business in Britain. Frustrated by the lack of accessible and consistent good quality data on Britain’s small business sector, the research director and principal author of the Report, Graham Bannock, strongly recommended that a regular survey of the small business sector be established in order to inform researchers and policy makers. With a mix of some public and mainly private sector funding and after a long gestation period, the Quarterly Survey was eventually born in 1984 under the direction of its inspirer, Graham Bannock. Making up for lost time, the Quarterly Survey has produced a report on the state of Britain’s small businesses every quarter ever since.

In the beginning, with entrepreneurship as an academic discipline in its infancy, the focus of the special topics each quarter was very much led by the concerns of financial institutions, interested government departments and bodies such as the Bank of England, Companies House, House of Commons Library, National Audit Office and so on. As academic, political and public policy interest in entrepreneurship and small business management grew, so too did the focus and reach of the Quarterly Survey. With this broadening of interest also came a significant shift in location when then Open University Business School Dean, Andrew Thomson, offered to host the Quarterly Survey in 1989. Some 20 years later, with an increase in enterprise activities across the University, the Dean at the time Professor James Fleck welcomed the Quarterly Survey formally into the Open University as a core element in its enterprise research.

The Quarterly Survey has been used widely as an economic barometer since it began in 1984. It has been and remains an important resource for SME academics, policy-makers and professional support practitioners (such as accountants, bankers, consultants and lawyers). It reveals quarterly and longer term trends on entrepreneurship and key small business issues. It also provides benchmarks for gauging SME regional, sector and size-related performance. The survey findings are regularly reported in the national press and other media. In addition, each quarterly report contains a feature section on a selected small business issue. Recent features have included the impact of the ‘credit crunch’; how entrepreneurial and non-entrepreneurial small firms differ in their approaches to growth and the recession; sources of advice on business and regulation compliance; environmental performance and changing use of information and computing technologies.

The Quarterly Survey is the longest established report focused entirely on small businesses in Britain. It owes its survival and success to its historic knowledge of the SME sector; its dedicated and loyal research/production team, and the long term support from the Open University and from its main sponsors - ACCA (Association of Chartered Certified Accountants) and Barclays Bank. Together we have helped forge a worthy legacy of the Bolton Report.

Emeritus Professor Colin Gray
Quarterly Survey 2013 Q2

Please click in the appropriate circles and boxes or fill in the blanks. If you have any problems with, or queries about, this form, please email us at subs-entrepreneur@open.ac.uk or call Julie Sullivan on 01908 655831.

1 What is the legal status of your business?
   - Private (limited) company
   - Self-employed sole trader/sole proprietorship
   - Partnership
   - PLC
   - Other

2 Including yourself, how many people work in the business, including both full and part-time workers?

3a How many years have you been running a business?

3b How many years has your present business been trading?

4 Please describe in a few words the precise nature of your business:
   [Unfilled box]

5 Entrepreneurial firms are more competitive, growth-minded and innovative than other firms. Where would you put your firm on a scale of 1 to 10?
   [Unfilled box]

6 Have you taken on any new employees in the last two years?
   - Yes – our first (one)
   - Yes – but not our first (one)
   - Yes – several
   - No

7 Why did you take on this employee / these employees?
   - To replace an employee who had left
   - To cope with increased workload
   - To take on a specific task or function (e.g. generate extra sales, build website)
   - As succession planning for a key person already in the business
   - Other reasons

8 Why did you not take on any employees?
   - High cost of employing staff
   - Employment regulations and ‘red tape’
   - Risk of losing control of the business
   - Risk of differences in approach or standards of work

9 What are their main tasks or functions?
   - Manufacturing and/or Service Delivery
   - Marketing and/or Customer Services
   - Recruitment and/or other Human Resources
   - Information Technology and/or Website
   - Accounting, Financial Management or Payroll
   - Other (specify)

10 Have you contracted out / employed agency workers for any tasks or functions in the last two years? Options as for Q6

11 What tasks or functions have you contracted out / employed agency workers for?
   [Unfilled box]

12 Where is / are your contractor(s) located? Options as for Q9

13 What was the MAIN reason for contracting out / employing agency workers for these tasks or functions rather than keeping them in house? Was it...
   - Lower cost
   - More flexible
   - Higher quality
   - More reliable
   - Other (specify)

14 Please explain in more detail why you decided to contract out particular tasks or functions

15 Please explain in more detail why you decided to keep particular tasks or functions in-house

16 In which of the following ranges is your firm’s annual turnover (excluding VAT):
   - Less than £50,000
   - £50,000 - £99,999
   - £100,000 - £249,999
   - £250,000 - £499,999
   - £500,000 - £999,999
   - £1m - £2m
   - £2m - £5m
   - £5m - £10m
   - £10m - £20m
   - Over £20m

The next three questions ask how your sales turnover, average employment and investment (in plant, equipment and premises) in the past quarter, compared with the same quarter last year:

17a Was your sales turnover in January to March 2013 compared with January to March 2012:
   - Up
   - Same
   - Down

17b Was your average employment in January to March 2013 compared with January to March 2012:
   - Up
   - Same
   - Down

17c Was your investment in January to March 2013 compared with January to March 2012:
   - Up
   - Same
   - Down

The next three questions ask how you expect your sales turnover, average employment and investment (in plant, equipment and premises) will have changed in the current quarter compared with the same quarter last year:

18a Expected sales turnover in April to June 2013 compared with April to June 2012:
   - Up
   - Same
   - Down

18b Expected average employment in April to June 2013 compared with April to June 2012:
   - Up
   - Same
   - Down

18c Expected investment in April to June 2013 compared with April to June 2012:
   - Up
   - Same
   - Down

19 Which, if any, of the following is the TOP problem facing your business at the moment?
   - Economic climate or demand
   - Cashflow, payments or debtors
   - Interest rates or access to finance
   - Government regulations
   - Inflation or cost of inputs, etc
   - Lack of skilled employees
   - Lack of time/capacity
   - The total tax burden

20 What other major problems does your business face at the moment?

21 Please indicate the sex of the owner(s) of the business:
   - Male
   - Female
   - Joint Male/Female ownership

22 Please enter your Business Postcode: [Unfilled box]

23 Please enter any comments you have on the issues raised in this questionnaire: [Unfilled box]
Quarterly Survey of Small Business in Britain

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