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EXECUTIVE SUMMARY

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What drives productivity growth behind the frontier? A mixed-methods investigation into UK SMEs

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International evidence suggests productivity growth is most rapid among ‘frontier’ firms, i.e. those in the top decile of the productivity distribution. Other studies have identified the marked difference in sectoral productivity growth in the UK over the last decade. Here, we consider the drivers of productivity growth in SMEs which are ‘behind the frontier’. Looking at quantitative data on value added and turnover per employee growth in twelve 4-digit sectors (six in manufacturing and six in services) we find no consistent relationship between firms’ position in deciles of the productivity distribution and subsequent productivity growth. We also find few significant differences between the observable characteristics of firms behind the frontier which experience rapid and slower productivity growth. Behind the frontier, firm age, size, number of subsidiaries and investment are only weakly related to productivity growth, at least in the short-term. The lack of influence of these observable influences on productivity growth suggests the potential importance of other externally unobservable factors in shaping productivity growth. We explore these unobservables in in-depth interviews, highlighting a number of factors which characterise high productivity growth SMEs. These include: inspirational leadership, people management practices, strategic investments, data oriented operational management and product, market and tactical innovation. Few of the factors are sector specific, and none operates in isolation.

Our study emphasises the role of transformational leadership in driving productivity growth in SMEs and has implications for the targeting of SME policy interventions after the Covid-19 crisis. Policy interventions should be based on the idea that SMEs, irrespective of previous productivity, can achieve high growth if they have focused and effective leadership, if they have appropriate human resource management practices, if they are innovative and if operational management is data driven. This has implications both for the targeting of policy support and the need to support SME owner-managers with the skills they need to be effective leaders of transformational change. Scope exists to extend business network and mentoring schemes with few respondents in our interviews were currently engaged in business networks aimed at creating better businesses. Government also has a continuing role to stress the importance of developing leadership and management capabilities alongside any direct public support. This may be particularly important in years to come as investment in training is likely to come under particular pressure due to cash-constraints in the post-Covid recovery. Finally, our study emphasises the positive role that government procurement practices can have in stimulating innovation in SMEs. Post-Covid, the role of government as a lead customer may be particularly important in stimulating demand.