Policy Briefing

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. Here, we consider the drivers of productivity growth in SMEs which are 'behind the frontier' using a combination of quantitative and qualitative methods. SMEs' position in the productivity distribution, age, size, number of subsidiaries and investment are only weakly related to productivity growth, at least in the short-term. Interviews suggest a number of factors which characterise high productivity growth SMEs.

Key findings

Contrary to previous findings which show that the most productive firms in the economy- frontier firms - grow faster than other firms, we find no consistent relationship between firms' initial productivity level and subsequent productivity growth for SMEs who typically operate 'behind the frontier'. This finding is robust across twelve manufacturing and service sectors.

Moreover, we find no strong relationship between growth and the size of the firm, its age, its number of subsidiaries or its fixed investments. Together, our results suggest that observable firm characteristics are poor determinants of firms' productivity growth.

This focuses attention on unobservable organisational factors which we explore through interviews with a sample of high performing SMEs. Our qualitative analysis suggests a number of factors which characterise high performing SMEs: inspirational leadership, people management, data-driven operational management processes, strategic investments, and product, market and tactical innovation. Few of these factors are sector specific, although there are variations in how they are implemented. None operates in isolation.

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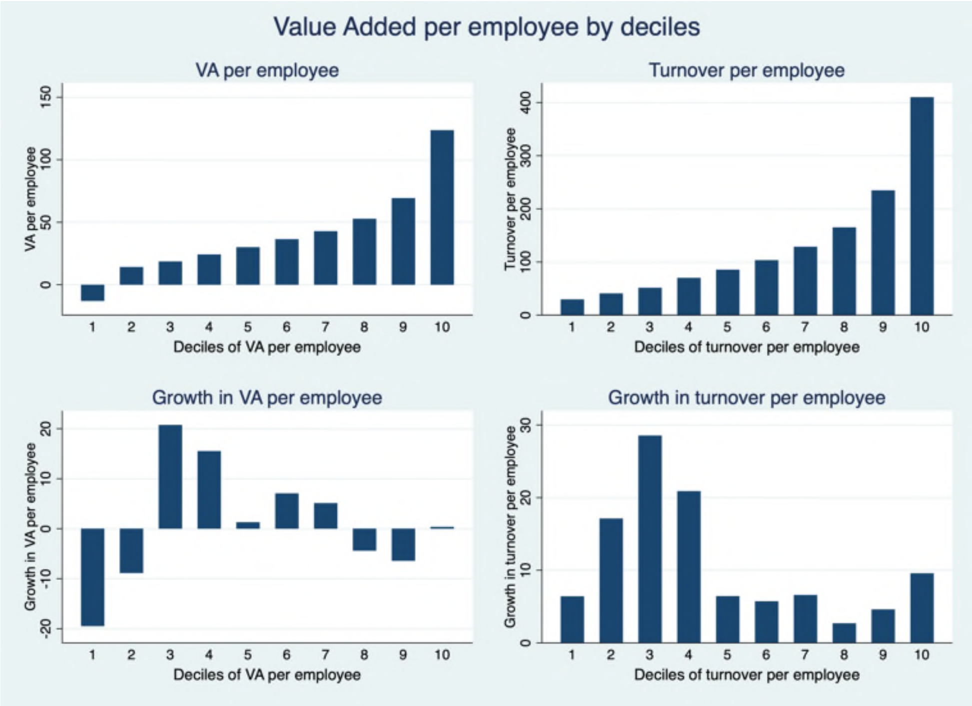
Understanding productivity growth

Using firm level data for twenty-four OECD countries, for example, Andrews et. al. (2015) showed that since 2001, the most productive firms in the economy - so called 'frontier firms' - grew their productivity around three times faster than other firms - the 'laggards' or non-frontier firms. In the OECD analysis frontier firms have average employment of 409 suggesting that most SMEs are 'behind the frontier'. Does the implied relationship between firms' position in the productivity distribution and productivity growth also hold for non-frontier firms? Figure 1 below depicts value added per employee and turnover per employee levels and growth for manufacturing SMEs in the UK. There is little consistent relationship between growth and productivity decile for SMEs. This also applies to services firms and in a range of specific sectors.

Figure 1: Productivity Levels and growth: Manufacturing SMEs



Policy implications

Our analysis suggests that observable firm characteristics are only weakly linked to subsequent productivity growth, so targeted policy interventions based on firm size, age, subsidiaries or investments are likely to be inefficient. Rather, policy interventions should be based on the idea that SMEs, irrespective of pervious 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 highlights the need to support SME owner-managers with the skills they need to be effective leaders of transformational change. This, in turn, should lead SMEs to adopt positive practices to manage their people, and introduce practices that are conducive to innovation. This provides strong support for interventions such as the recently announced Small Business Leadership Programme which aims to help SME leaders develop strategic leadership skills and develop and implement strategic plans to improve performance.

Full paper link:
http://www.enterpriseresearch.ac.uk/our-work/publications/?type=whitepaper-research