ERC
Enterprise Research Centre

The State of Small Business Britain 2024

Rising to the challenge

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UKRI Economic and Social Research Council

The Enterprise Research Centre (ERC) is an independent research centre based at Warwick and Aston University Business Schools which focuses on growth, innovation and productivity in small and medium-sized enterprises.

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Foreword

The State of Small Business Britain report is the Enterprise Research Centre's (ERC) annual review of trends and issues affecting small businesses in the UK. The report draws together the Centre's latest research to give a picture of the UK's small business population and the challenges and opportunities that lie ahead of them.

Since its inception, the ERC has delivered high quality research and analysis that enables informed discussion on the issues that affect the growth and productivity of small enterprises. The team have always placed a strong focus on working in partnership with stakeholders, to ensure that their research has an impact on policy thinking, development and implementation.

At the time of writing the report - the end of 2024/early 2025 - the situation for the UK's small business community remains challenging, with many continuing to feel the pinch from cost-of-living pressures and inflation, as well as dealing with the implications of several major political and technological shifts. Given this context, and after an extended period of instability in business support funding, there is an urgent need for the Government to provide more stability and continuity going forward. There are undoubtedly many uncertainties lying ahead for small businesses in 2025, but there are also opportunities for positive change if they have a supportive ecosystem behind them. Now more than ever there is a strong case for insightful research to underpin effective policy.

We hope that you find this report informative and useful. Please do get in touch with the ERC team if you would like to provide feedback, have a conversation, or if you'd just like to find out more about the Centre's research. You can find contact details on the ERC website at: **https://www.enterpriseresearch.ac.uk/**

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Executive Summary

The past 12 months has been another extremely challenging period for the country's small businesses. At the same time as managing the ongoing cost-of-living pressures and operating within a general climate of economic uncertainty, business leaders have also had to deal with the implications of some major technological and societal shifts, all whilst navigating a fragmented business support system.

After the general election last summer, the new Government began setting out their mission to deliver stronger economic growth for the UK. The autumn period saw several new policy announcements that will have impacts for small businesses in 2025. These included a new Employment Rights Bill, as well as increases in employers' National Insurance Contributions, the National Living Wage and Minimum Wage, and changes to relief on business rates. The reaction to these announcements dominated many discussions amongst the business community at the end of 2024 and in early 2025.

There will be many challenges for small businesses to manage in 2025, but there are also opportunities for leaders and managers to make positive changes. Taking advantage of these opportunities, however, will require agility and adaptation, and in many cases will involve wider reassessments of strategy and approach. If we are to have a realistic chance of meeting the Government's ambitious growth aspirations, it is essential that action is taken on the pressures that are constraining small businesses, including rising costs, poor payment practices and economic uncertainty, and that new policy initiatives such as the new Business Growth Service are responsive to the real-life needs of small businesses leaders and the people that work in them, as well as being informed by robust research evidence.

HEADLINE FINDINGS

Business context

Findings from the 25th anniversary Global Entrepreneurship Monitor (GEM) Survey show that the UK is a significantly more entrepreneurial society than it was at the start of the millennium. 30 per cent of working-age individuals in the UK either intended to start a business within the next three years, were actively trying to start a business, or were already running their own business.

The pandemic was an extremely challenging time for small businesses, but the GEM Survey findings show that it also prompted a notable rise in early-stage entrepreneurial activity across all four of the UK home nations.

However, a substantial amount of this growth in early-stage entrepreneurial activity is being driven by individuals pursuing entrepreneurship out of necessity. Around two-thirds of entrepreneurs say that a motivating factor for them is "to earn a living because jobs are scarce."

At the same time, a fear of failure amongst the non-entrepreneurial population is at a historically high level. Six out of ten non-entrepreneurs say that a fear of failure would prevent them from starting their own business.

Data from the Business Insights and Conditions Survey (BICS) shows marked changes in business concerns in 2024. Falling demand for goods and services, increased competition and taxation all became increasing concerns compared to 2023. By contrast, inflation, energy prices and interest rates became less important preoccupations for businesses.

When asked to consider their concerns about business turnover specifically, the cost of labour and materials, economic uncertainty, and competition were the concerns most frequently cited by SMEs.

Growth and productivity

Previous ERC research has demonstrated that only a small proportion of small businesses in the UK reach significant growth milestones. In fact, business growth is becoming rarer in the UK. Analysis of the ONS Business Structure database shows that although there are 400,000 more established SMEs than in 2010, the proportion registering any growth in employment has fallen from 20 per cent to just 13 per cent.

Of the 325,811 start-ups registered in 2020, only 47 per cent survived to 2023, and of these only 2 per cent (3,049) managed to achieve the milestone of £1m turnover after three years. This is a proportion that has remained constant over the UK in the last decade.

Between 2020 and 2023, only 7 per cent of those firms that had managed to reach £1-2m turnover continued their growth journey and were able to 'step up' to reach the milestone of over £3m turnover. Furthermore, only a minority of firms are able to grow their turnover whilst also continuing to hire.

New ERC research published in 2024 shows that a range of factors affect business investment decisions in firms. Positive influences on investment include the financial health of the business, higher levels of human capital, better management practices and a positive attitude towards business growth.

The small business ecosystem

Data from the GEM Survey indicates that the UK has several persistent weaknesses in its small business ecosystem. Since the pandemic, the UK has been part of a group of high-income economies that have seen their overall entrepreneurial environments slip from being regarded by experts as 'sufficient' to 'less than sufficient'.

The scores given by experts for the two entrepreneurial finance measures included in the GEM Survey (entrepreneurial finance provision and ease of access to finance) have fallen over the last three years. Further, there has been a weakening in a number of other areas including government policies around business support and physical infrastructure.

New ERC research on equity finance amongst UK early-stage ventures shows that the journey to accessing equity finance is often long and difficult. One-third of the firms we surveyed had sought equity finance in 2022-23, but only half of these were receiving any finance, with the average amount of their finance being only two-fifths of their application requirement. Firms had typically also made multiple (five or more) applications.

Data from the Longitudinal Small Business Survey (LSBS) panel report shows that there has been a steady increase in the proportion of SMEs using business support since 2020, rising from about a quarter of firms (24.1%) in 2020 to 27.3 per cent in 2023.

ERC research has provided more evidence on the impact of business support on productivity. One report based on analysis of the LSBS showed that firms that used external advice saw an average increase in their labour productivity by 22.1 per cent, and that accessing business advice improved firm innovation.
New ERC analysis has also found that both gender and ethnic diversity in leadership are positively associated with a higher likelihood of seeking business advice, and that this advice also provided stronger innovation benefits in diverse firms.

Innovation

Data from the UK Innovation Survey (UKIS) shows a sharp decrease in innovation in recent years. 36 per cent of firms were innovating in 2020-2022 compared to 45 per cent in the 2018-2020 period. Large businesses are much more likely to be innovation active than their smaller counterparts. In 2020-2022, the UKIS found that 50 per cent of large businesses were innovation active, compared to just 36 per cent of SMEs.

The 2024 Innovation State of the Nation Survey (ISNS) found that 56 per cent of businesses reported making product or service changes over the last year, falling from 61 per cent in 2023. Innovation rates fell more in small and micro-businesses than in larger firms.

The ISNS shows that innovation is strongly associated with higher sales growth. In 2023, the sales growth of innovating firms was 10 per cent compared to three per cent for non-innovating firms. In 2024, the gap narrowed slightly, with innovating firms growing around 7 per cent compared to two per cent for non-innovators.

The after-effects of the Covid-19 pandemic and the cost of doing business crisis were the most commonly cited barriers to innovation in the ISNS. Firms said they would need/demand more innovation support over the next year.

New ERC research based on analysis of the LSBS reveals disparities in the adoption of digital technologies amongst SMEs. Artificial Intelligence (AI), robotics, automation, and VR/AR technologies are less frequently adopted than other technologies such as accountancy software. There are also differences in technology adoption by gender and location.

Other new research highlights the tensions small business leaders face when adopting net zero practices, such as conflicts between sustainability and business goals. These can lead to firms becoming stuck in a ‘cycle of inaction’ when it comes to sustainability initiatives.

Management and leadership

New ERC research has shown that greater workforce diversity and inclusive working practices are strongly associated with higher levels of innovation activity.

Our longitudinal research on workplace mental health in Midlands firms shows a growth in long-term mental health related sickness absence in 2024 and ongoing issues with presenteeism. The level of employer-reported presenteeism remained higher than it was pre-pandemic, reported by 37.2 per cent of firms in 2024. There is an ‘attitude to action’ gap when it comes to workplace mental health initiatives. Although there has been a growth in the proportion of firms adopting initiatives since the pandemic, 20 per cent more firms say they believe that they should address mental health than are actually taking action.

Smaller firms are much less likely to have workplace mental health initiatives in place when compared to their larger counterparts. For example, 47 per cent of firms with 10-19 employees had initiatives in place compared to 72 per cent of firms with 50-249 employees, and 90 per cent of firms with 250+ employees. Changes in working practices, particularly the rise in remote and hybrid working bring new challenges for employers. Although 72 per cent of employers believed that employees working from home were happier, 53 per cent said that it made teamworking more difficult and 46 per cent said that employees working remotely can struggle because they lack interaction with others.

Our Manifesto for Small Business Growth and Productivity

In 2024 we produced a manifesto for small business growth and productivity, based on a decade of evidence-based insights. This highlights several priority areas for focus and action, summarised below. It is essential to see more progress in these areas in 2025:

- **We need to ensure the UK has more evidence-based enterprise policy**. Small business policies and initiatives need to be firmly based on the evidence about what small businesses need and what works. We need to make better use of the full range of data sources available, as well as drawing on the insights of small business leaders themselves.
- **We need to take action to improve the UK's small business ecosystem**. This means developing a small business support ecosystem that is focused on creating the conditions for sustainable growth and improving productivity amongst the UK's diverse population of small businesses. This needs to be based on an understanding of the complex patterns of start-up, survival and growth that exist rather than focused on rigid definitions of 'high growth' firms.
- **The UK needs a coherent, joined-up, stable government-funded business support system** that draws on existing expertise, recognises the valuable role played by professional business advisers and provides support tailored to advancing the potential of underserved groups including women and ethnic minority entrepreneurs.
- **Action needs to be taken on small business finance**. We need to ensure that the UK's small businesses are better informed about the range of finance options available to them, that finance is more inclusive and accessible, particularly to underserved groups, and that the enduring late payment problem is tackled.
- **We need to encourage and enable more innovation activity in small businesses** and address the disparities that exist in innovation activity between places through locally based and intelligence-informed strategies.
- **Small businesses need more support in adopting net zero practices**. The UK's small businesses urgently need access to quality, actionable information and advice to help them adopt net zero practices and measure their effectiveness.
- **We need more UK businesses to adopt digital technologies** that have the potential to improve their productivity through improving digital understanding and literacy amongst small businesses and providing training support.
- **We need to challenge the ambitions and management mindsets of the UK's small business leaders**, encouraging sustainable growth ambitions and enhancing management and leadership skills.
- **Urgent action is needed on workplace mental health and well-being**. We need to transform understanding amongst small business leaders of the importance of good mental health and well-being for productivity, and improve management training and behaviour in this area.
- **The export performance of the UK's small businesses needs attention.** We need to encourage more small firms to export, and support them to do so at different points in their export journeys, maximising the links between exporting and innovation.

1. The Small Business Landscape in 2024

In this section we set the context for this report by presenting some headline evidence on the small business landscape in the UK in 2024. We draw on a mix of recent findings from key secondary data sources.

1.1 Trends in business activity

1.1.1 Changes in the small business population

According to official data, the total number of private sector businesses in the UK at the start of 2024 was 5.5 million.[1] The majority of these - 99.8 per cent - were classified as small and medium sized enterprises (SMEs), officially defined as businesses with 0-249 employees, 99.2 per cent were small firms (with 0 to 49 employees), and 95 per cent were micro businesses (with 0-9 employees).

Total employment in UK SMEs was 16,637 million (just under 60% of the total), with small businesses employing 12,960 million people (just under 47% of the total). However, it should be noted that the majority of businesses in the UK do not actually have any paid employees aside from the owner(s). These non-employing firms accounted for 74 per cent of all private sector businesses in the UK in 2024. Small and micro businesses and self-employed people, therefore, play a crucial (and often, it has to be said, under-estimated) role in the UK economy. SMEs as a whole (including employing and non-employing businesses) accounted for an estimated 52 per cent of turnover.

Looking at recent trends in the SME business population, it is clear that the Covid-19 pandemic has had a marked impact. After a prior decade of increase (which was driven mainly by the growth of non-employing businesses), the UK's overall business population has decreased since 2020. Between 2020 and 2024, the total business population decreased by 482,000 (8%). Looking more closely at the data, there are differences in the extent of the decrease between employing and non-employing businesses. Whilst the number of employing businesses actually increased by 1 per cent during the period, the population of non-employing businesses decreased by 11 per cent, illustrating the impact of the challenges of the past five years on the self-employed.

Looking at population change over 2023 to 2024 specifically - the data shows that the overall private sector business population decreased by 1 per cent (56,000 businesses), with the SME business population also decreasing by 1 per cent.

1 Business population estimates for the UK and regions 2024: statistical release - GOV.UK

1.1.2 Changes in early entrepreneurial activity

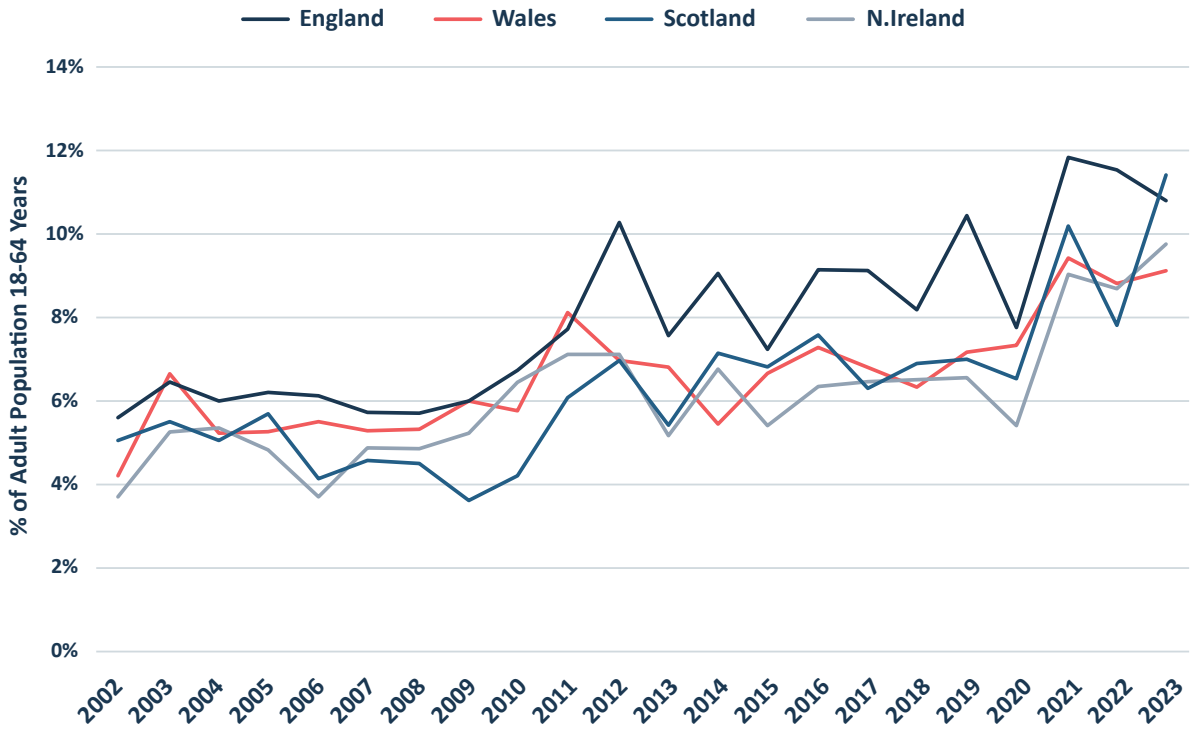
Turning to look at early-stage entrepreneurial activity, the most up-to-date, reliable information available in the UK can be found in the Global Entrepreneurship Monitor (GEM) survey. GEM data is available on an annual basis from 1999 when the project was first launched, and is the most authoritative source of data on entrepreneurial activity as well as attitudes and aspirations.

The findings from the most recent GEM survey carried out in 2023 show - encouragingly -that the UK continues to have a strong entrepreneurial culture. For the first time since GEM records began in 1999, just under 30 per cent of working-age individuals in 2023 either intended to start a business within the next three years, were actively trying to start a business, or were already running their own business.

The rate of total early-stage entrepreneurial activity (known as the TEA rate), which is the sum of nascent entrepreneurship and new business ownership/management, has increased over time in the UK. This now looks to have stabilised at around 11 per cent, compared to the 6-7 per cent found during the first decade of the new millennium. The increase in the TEA rate over time can be seen as an indicator of the entrepreneurial creativity and resilience found in the UK.

Although entrepreneurial confidence was undoubtedly knocked by the pandemic, the GEM survey findings show that it also prompted many individuals began to re-evaluate their position in the labour market and take control of their future economic activity at a time of great uncertainty. [2] Looking at variation by geography, as Figure 1 shows, post-pandemic there was a notable rise in early-stage entrepreneurial activity across all four home nations.

Figure 1: Total early-stage Entrepreneurial Activity (TEA) in the Home Nations 2002-23



Source: GEM APS 2002-23

2 GEM Global Entrepreneurship Monitor

Further analysis also reveals that London is an outlier and a primary driver of early-stage entrepreneurial activity within England. In fact, early-stage entrepreneurial activity rates in the other English regions (excluding London) are comparable to those of the three devolved home nations throughout the whole period.

Notably, there has also been a remarkable increase in the level of early-stage entrepreneurial activity by women in the UK since 2002 from just over 3.5 per cent to 10 per cent - a three-fold increase - which accelerated after the pandemic. Looking back, the relative participation of women engaged in entrepreneurial activity in 1999 was the highest in those countries with the highest start-up rates, such as the US (60%) while in the UK it was only 41 per cent. However, in 2023 it stood at 85 per cent in the UK as a result of the steady rise in women setting up their own businesses. Work by the GEM UK team for the Royal Bank of Scotland in 2012 and the subsequent Rose Review of female entrepreneurship in 2019, has focused attention on this topic along with other initiatives across the UK. The situation is rapidly improving, although major obstacles for female entrepreneurs certainly remain, especially with respect to access to equity finance and venture capital which are still a major issue.

Ethnic-minority entrepreneurship has historically made a strong and vibrant contribution to total entrepreneurial activity in the UK. GEM data has shown that Asian, Caribbean, and African communities are all more entrepreneurial than their White counterparts. The UK's immigration policy was seen by some experts in 2002 as attracting a rich and diverse range of skills and attributes into the business community, although in subsequent years there has been considerable change in this policy area. However, in the period between 2003-2023, the early-stage entrepreneurial activity rates of immigrants continues to be considerably higher than those of UK life-long residents by 1.6 times on average.

The GEM surveys also provide much-needed insights into entrepreneurial motivation, showing that there are a variety of drivers lying behind engagement in entrepreneurship. In particular, the latest report observes that there has been a 'notable uptick' over time in the share of early-stage entrepreneurial activity that is driven by individuals pursuing entrepreneurship out of necessity. Around two-thirds of entrepreneurs say that a motivating factor for them is "to earn a living because jobs are scarce", with women more likely to indicate this applies to them. The latest report points out that caring responsibilities continue to be a major issue impacting women's economic participation, with many women moving into entrepreneurship for work-life balance reasons.

Despite showing a generally positive picture of increasing early-stage entrepreneurship over time in the UK, the latest GEM survey does, however, also report that 'fear of failure' amongst the non-entrepreneurial population is now at historically high levels. Six out of 10 non-entrepreneurs say that a fear of failure would prevent them from starting their own business. This figure reflects wider socio-economic trends, rising after the Brexit referendum and the Covid-19 pandemic. This is an issue also affecting other countries too, and the report authors note that it remains a 'formidable obstacle to new start-ups'.

1.2 Trends in SME performance

1.2.1 Growth-related behaviours

The UK Longitudinal Small Business Survey (LSBS) explores a range of topics relating to small business growth and performance and the factors that affect it, with a panel element that allows us to see how business attitudes, behaviours and performance change over time.

In 2024, a LSBS panel report was published that reported findings from a group of 1,285 firms that responded to the 2020, 2021, 2022, and 2023 surveys.[3] The report shows some interesting trends in growth and drivers of growth amongst small businesses that are worth discussing here.

Overall, looking at patterns of growth, the panel data confirms that it was not common for firms to have experienced sustained growth in either employment or turnover over the 2020 to 2023 period. Only 14.5 per cent of firms surveyed achieved sustained growth over all of these four years. In addition, expectations of employment growth were also unrealised for many of the businesses. Around half (49.3%) of the businesses that said that they had expectations of employment growth in 2022 actually achieved this in 2023.

Another increase was found in employer investment in training. In 2020, 44.6 per cent of firms reported investing in employee training. This proportion fell during 2021 to 43.4 per cent, but rose to 47.2 per cent of firms in 2023. These changes are likely to be related to the impact of changing work patterns during and after the pandemic.

1.2.2 SME financial health

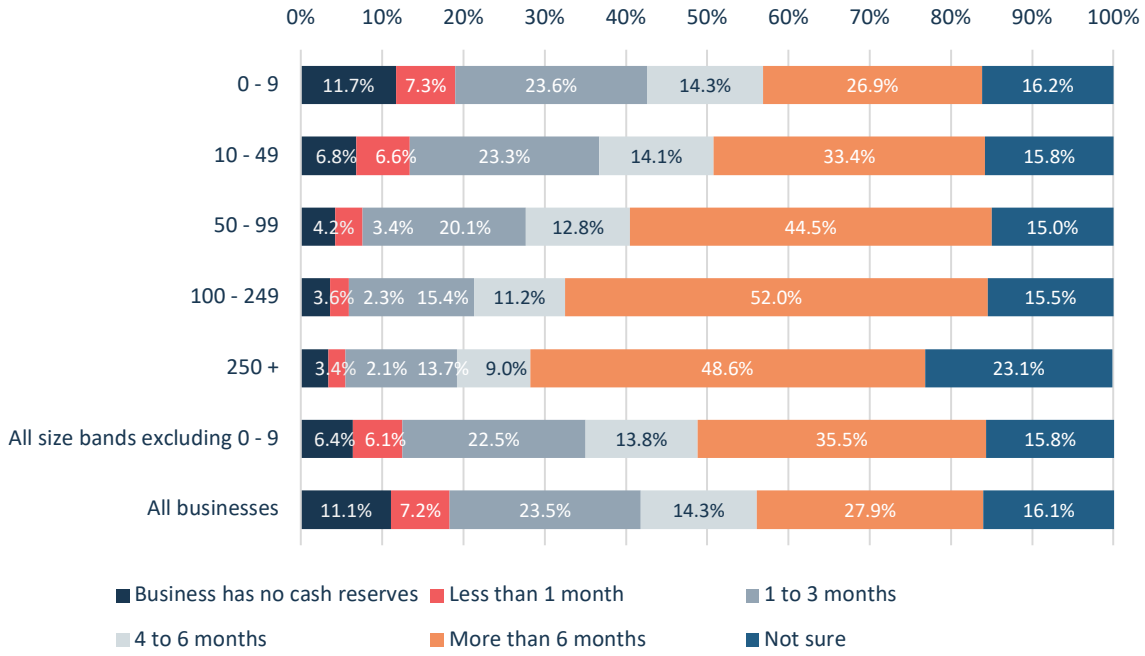
Since 2020, the Office for National Statistics (ONS) Business Insights and Conditions Survey (BICS) has provided a valuable source of information on a range of trends in UK businesses. [4] BICS is a voluntary fortnightly survey asking a range of questions about financial performance, workforce, prices, trade, and business resilience.

The BICS provides useful data on the financial health of UK businesses. One key measure here is cash reserves, or the money firms keep aside to meet their short-term and emergency funding needs. Figure 2 shows how long businesses think their cash reserves will last by size (using data from wave 116 of BICS in September 2024).

Around 56 per cent of currently trading business reported that they only expected their cash reserves to last for up to six months. When looking at the breakdown by business size, the highest percentage of firms with no cash reserves is observed among micro-businesses employing 0-9 employees (11.7%) and small businesses with 10 to 49 employees (6.8%). One in four micro-businesses and one in three small businesses estimated that their cash reserves would last more than six months, compared to almost half of medium and large businesses, reflecting the financial challenges the smallest businesses face.

3 https://www.gov.uk/government/statistics/small-business-survey-2023-panel-report/small-business-survey-2023-panel-report
4 https://www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/businessinsightsandimpactontheukeconomy

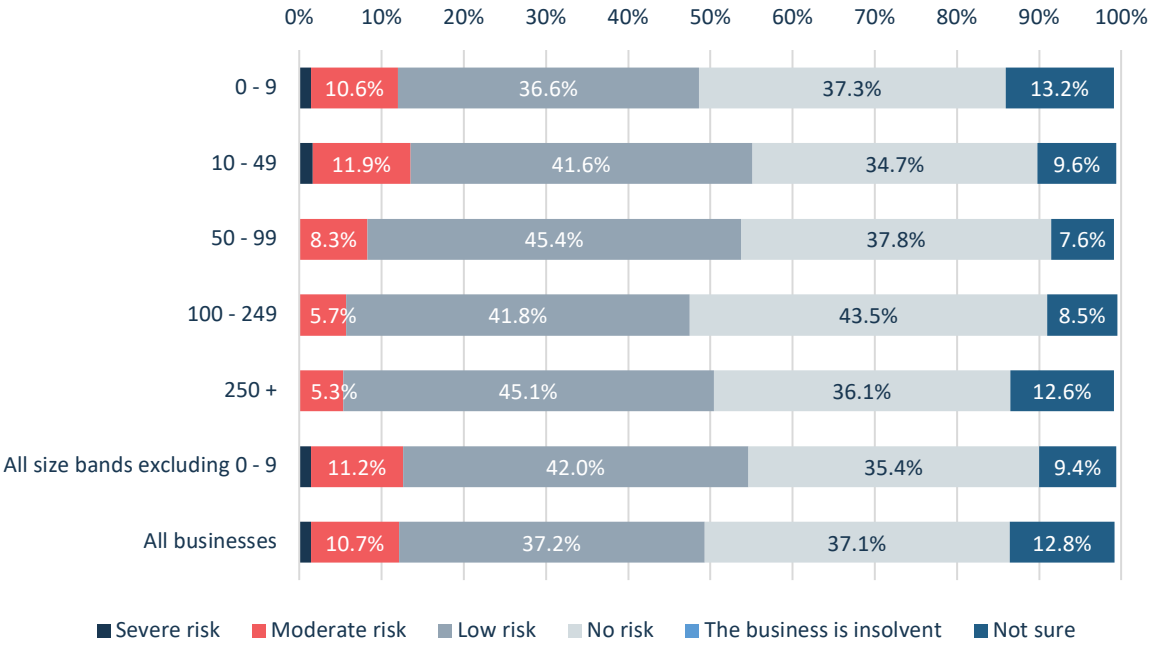
Figure 2: Businesses cash reserves by firm size



Source: ONS Business Insights and Conditions Survey data, Wave 116 (2 September 2024 to 15 September 2024)
Notes: Question: 'How long do you expect your business's cash reserves will last?'; as percentage of currently trading businesses, weighted count, UK.

Another measure of financial health is insolvency risk. Figure 3 below shows the perceived risk of insolvency by business size. When looking at the breakdown by firm size, the highest proportion of businesses evaluating the risk of insolvency as 'severe' or 'moderate' is observed among micro businesses (12.0%) and small firms (13.5%), although most firms feel there is low or no risk.

Figure 3: Risk of insolvency by firm size



Source: ONS Business Insights and Conditions Survey data, Wave 116 (2 September 2024 to 15 September 2024)
Notes: Question: 'What is your business's risk of insolvency?'; as a percentage of businesses not permanently stopped trading, weighted by count, UK.
'Severe risk' is excluded because of low counts for confidentiality reasons for businesses with over 50 employees; same for 'the business is insolvent' for all size categories.

1.3 Business concerns

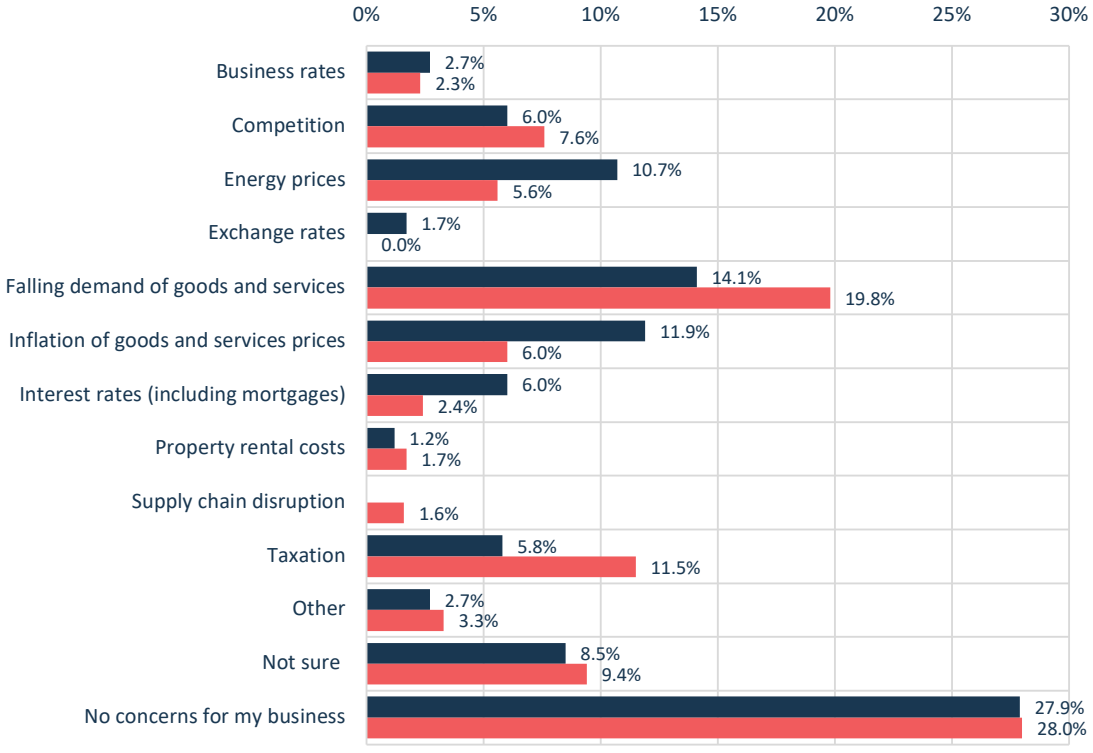
As well as covering financial health, the BICS also provides useful information on other key concerns that are affecting businesses. There have been some marked changes and fluctuations here over the past few years, reflecting the rapidly changing economic context.

As Figure 4 shows, the highest concern for businesses in October 2024 was falling demand for goods and services, with 14.1 per cent of businesses surveyed highlighting this. This is an increase of almost 6 per cent compared to the same period in 2023. On the contrary, inflation, energy prices and interest rates became less important preoccupations than in 2023. The share of businesses saying they were concerned by energy prices dropped from 11 to 5.6 per cent compared to the same period last year. The percentage of businesses concerned by inflation of goods and services decreased from 12 per cent to 6 per cent. Only 2.4 per cent of businesses said that they were concerned by interest rates, compared to 6 per cent in October 2023.

However, an increasing number of businesses said they were concerned by taxation (11.5 per cent in October 2024 compared to 5.8 per cent last year). Increasing competition continued to preoccupy businesses in 2024 too, with 7.6 per cent reporting this as main concern.

Looking over the wider period February 2022 - October 2024 at the business concerns question, we can see that business concerns about inflation and energy prices reached their respective peaks in Autumn 2022 (26.8% of businesses concerned by inflation and 22.7% concerned by energy prices). These concerns were progressively replaced by preoccupations about falling demand, competition and taxation. On the positive side, 28 per cent of businesses reported they had 'no concerns' for their business in October 2024, which is the same level as the same time in 2023 and as in Spring 2022.

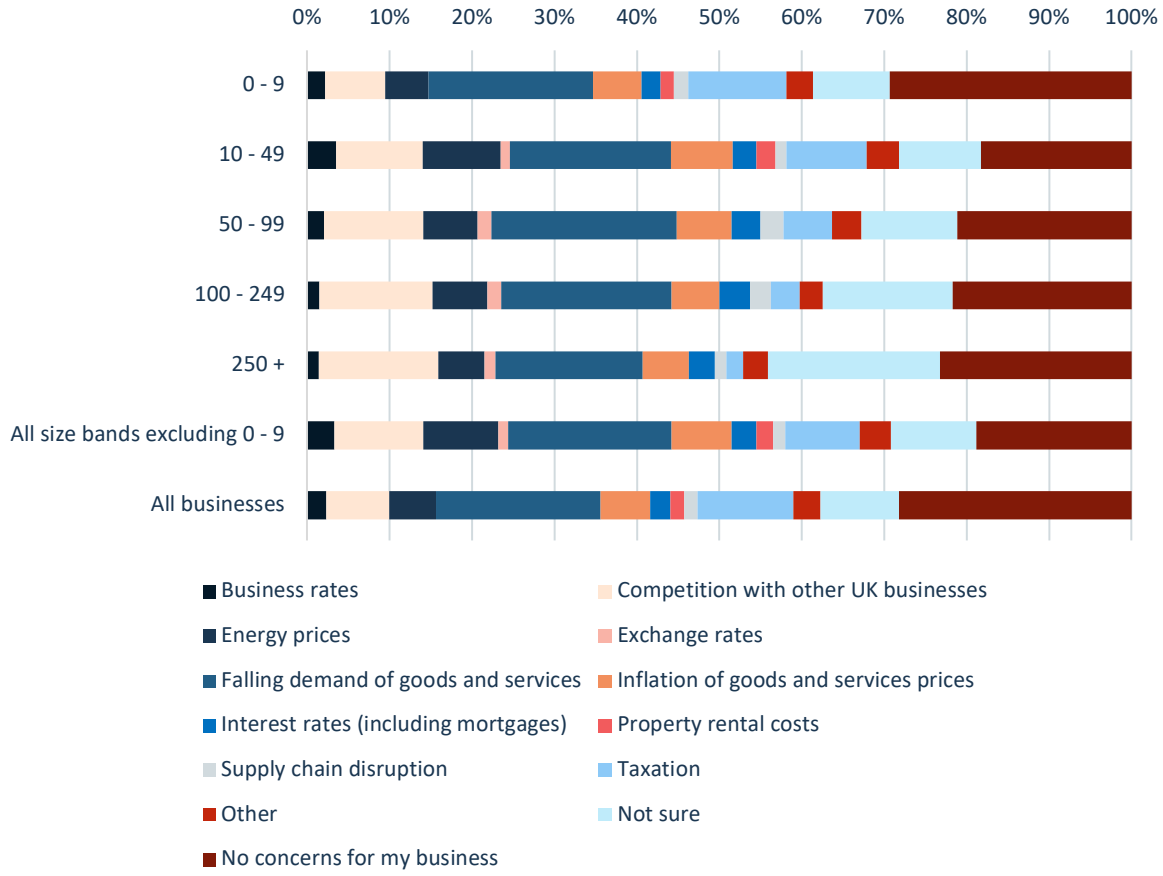
Figure 4: Business concerns



Source: ONS Business Insights and Conditions Survey data, Waves 92 (1 October 2023 to 31 October 2023) and 116 (1 October 2024 to 31 October 2024)
Notes: Question: 'Which of the following, if any, will be the main concern for your business in October 2023 /October 2024?'; as a percentage of businesses not permanently stopped trading, weighted by count, UK.

Figure 5 shows that falling demand was also the main concern for businesses across all size categories. Energy prices remained a concern for almost 1 in 10 small businesses (10-49 employees) (9.5%). Micro-businesses with 0-9 employees and small businesses showed the highest rates of concern with taxation, with 12 and 10 per cent of businesses reporting this as a concern.

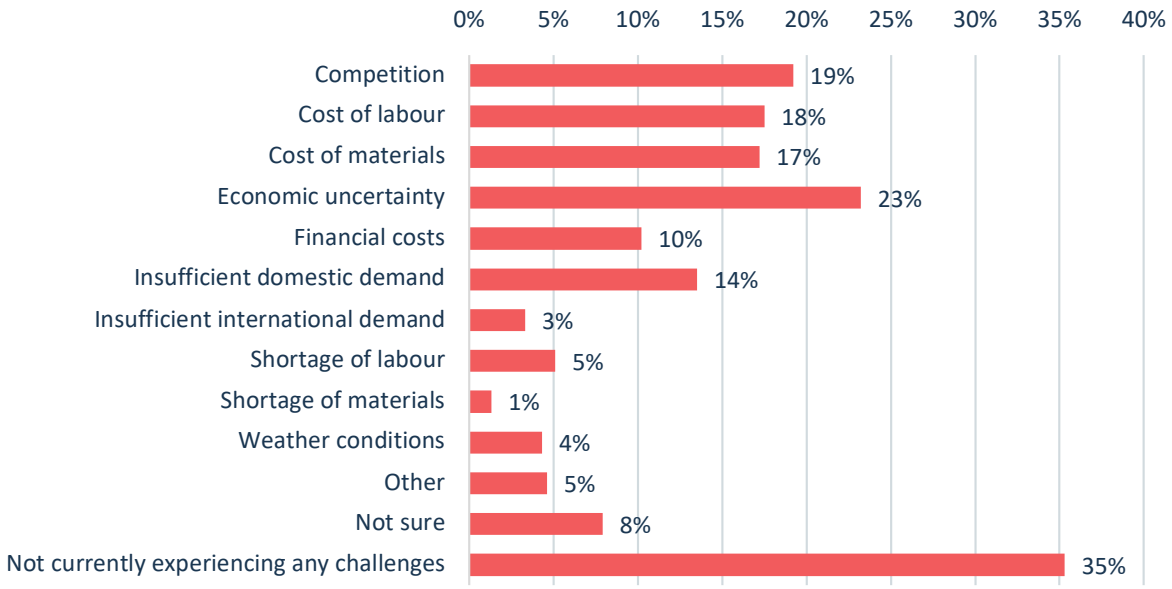
Figure 5: Business concerns by firm size



Source: ONS Business Insights and Conditions Survey data, Wave 116
Notes: Question: 'Which of the following, if any, will be the main concern for your business in October 2023?'; as a percentage of businesses not permanently stopped trading, weighted by count, UK.

The BICS also explores the challenges that businesses feel are currently impacting their business's turnover specifically (Wave 120, live from 2 September 2024 to 15 September 2024). As Figure 6 shows, around one in five business in the UK said that competition was impacting their business turnover. Around 14 per cent of businesses also said that their turnover was impacted by insufficient domestic demand, and this percentage is higher for small and medium sized businesses (around 17%).

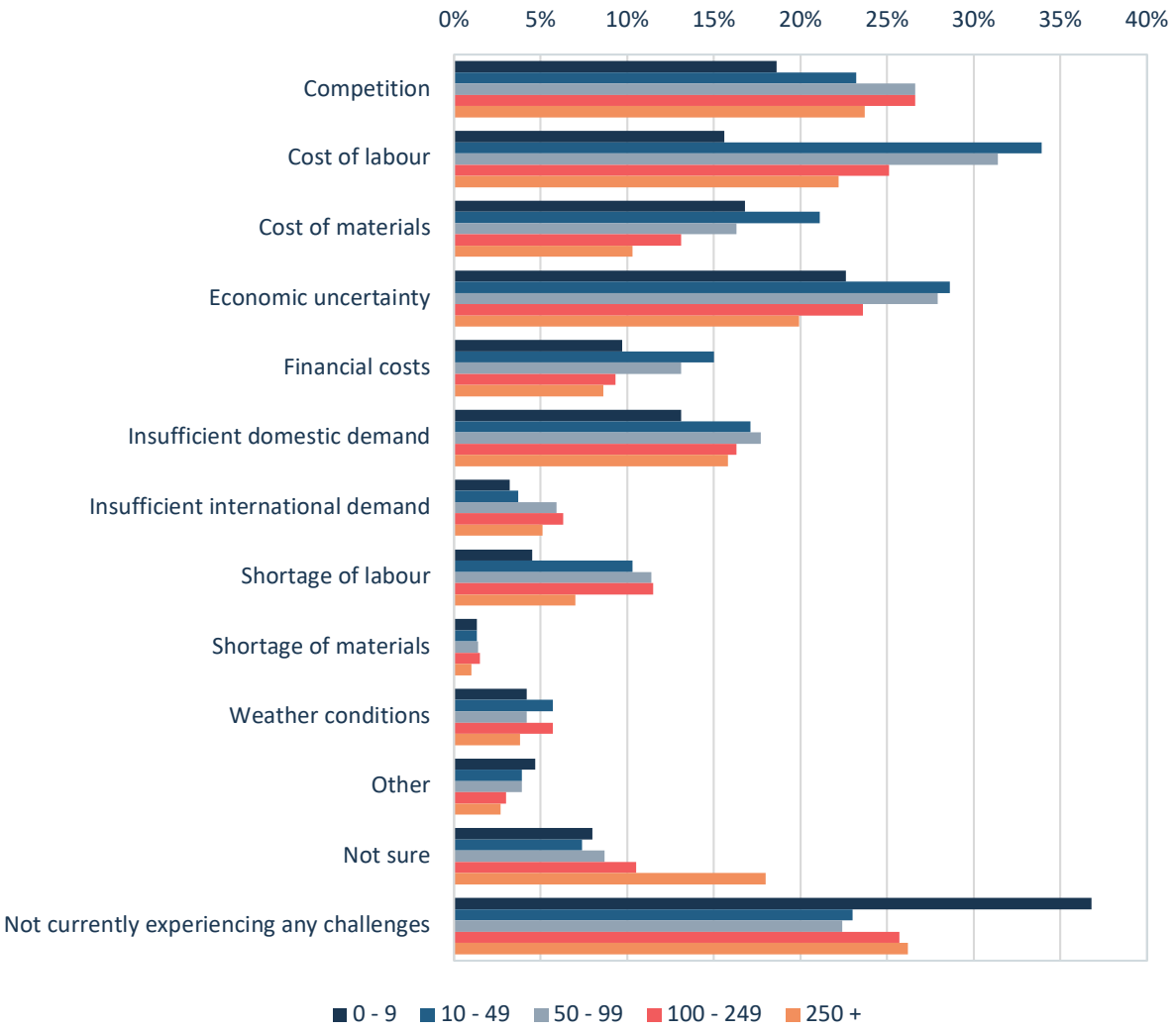
Figure 6: Challenges impacting turnover (all businesses)



Source: ONS Business Insights and Conditions Survey data, Wave 120 (4 November 2024 to 17 November 2024)
Notes: Question: 'Which of the following challenges, if any, are currently impacting your business's turnover?'; as a percentage of businesses not permanently stopped trading, weighted by count, UK

However, the most frequently cited factor affecting turnover was economic uncertainty, which was reported most by small (29%) and medium-sized businesses (28%) (see Figure 7). For these categories of business, however, the most frequently cited factor impacting turnover was the cost of labour (34% and 31% respectively), with a considerably higher proportion concerned with this than found amongst large businesses (22%).

Figure 7: Challenges impacting turnover by size



Source: ONS Business Insights and Conditions Survey data, Wave 120 (4 November 2024 to 17 November 2024)
Notes: Question: 'Which of the following challenges, if any, are currently impacting your business's turnover?'; as a percentage of businesses not permanently stopped trading, weighted by count, UK.

Although it is not specifically asked about in the BICS, it should be noted that poor payment practices are also an issue that has an impact on the turnover of many small businesses. As we noted in our 2023 State of Small Business Britain report, poor payment practices - which include delays to invoices being paid and long payment terms - have been recognised as causing serious cashflow issues and major barriers to small business growth. According to data from the Xero Small Business Insights report for June-September 2024, small businesses were paid an average of 6.4 days late in the September quarter.[5] The average time small businesses waited between issuing an invoice and getting paid was 28.4 days. The ERC is currently working in partnership on new research on late payments which will explore the impacts on businesses and estimate the annual economic burden that late payments impose on the UK economy, and this will report in 2025.

5 Xero Small Business Insights | Xero

1.4 Summary

Headline data indicates that 2024 was a challenging year for the UK's entrepreneurs and small businesses, with rising concerns about falling customer demand and a persistent climate of economic uncertainty taking its toll on business and entrepreneurial confidence. There is evidence of a concerning continued decline in some important growth-related behaviours, namely exporting and innovation activity, although there were more potentially encouraging trends in some areas such as the increasing proportion of firms using business support. All of this has important implications for growth, productivity and wider well-being. In the next chapters we turn to look at the findings from ERC research undertaken and published during 2024, and consider their implications for businesses, policymakers, business support organisations and for the enterprise research agenda.

2. Business Growth, Productivity and Investment

Business growth and productivity have been enduring research themes for the ERC, reflecting the longstanding nature of the UK's 'productivity puzzle' and persistent issues around growth amongst the small business population. We continued to build valuable insights in this area through our research in 2024 that provides useful evidence to policymakers.

2.1 Trends in small business growth

The number of start-ups in an economy is often used as a key indicator of business growth, but less attention tends to be given to the proportion of businesses that survive and go on to create healthy revenues. However, ERC analysis has shown that the UK has a high proportion of start-ups that do not survive, and that only a small proportion of firms reach significant scaling milestones.

Business growth has become even more rare in the UK since the Great Financial Crisis - there are 400,000 more established SMEs (3 years +) since 2010 but the proportion registering ANY growth in employment has fallen from 20 per cent to 13 per cent. There has been a lot of interest in recent decades by researchers and policymakers in the scaling process of start-ups and established firms and in the UK, this was turbo-driven by the NESTA 'Vital 6%' report published in 2009,[6] which was underpinned by analysis undertaken by the ERC, using for the first time at the request of NESTA, the OECD High Growth metric first rolled out in 2006.[7]

Those familiar with ERC research will know that in recent years we have identified the limitations of using the OECD metric of a High Growth Firm to inform the development of a 'fast-growth' business support offer in the UK (or indeed in any country). We will not rehearse those arguments again here as they have been set out elsewhere.[8] Instead of relying on this measure, we have developed a set of new metrics over the years which, used together, better reflect the episodic nature of how businesses grow, and as a result may shed more light on the associated policy issues. These metrics include:

- Start-ups scaling to £1m turnover and over within 3 years. Chosen because of the oft-cited ambition of many entrepreneurs to 'reach their first million' in turnover. Expressed as a percentage of all start-ups surviving three years.
- Established firms (i.e., trading for at least 3 years) that had £1-2m turnover in 2020 scaling to £3m+ in 2023 – i.e., 'kicking on beyond the first million'.
- Established firms (i.e., trading for at least 3 years; 1-249 employees) registering productivity gains (i.e., turnover per employee) and doing so while still creating jobs. We have called these small businesses 'Productivity Heroes'. These firms are growing both their revenues and headcount but their revenues at a faster rate, expressed as a percentage of all firms increasing productivity.

6 https://www.nesta.org.uk/report/the-vital-6/
7 https://www.nesta.org.uk/report/measuring-business-growth/
8 Hart, M., Prashar, N., & Ri, A. (2021). From the Cabinet of Curiosities: The misdirection of research and policy debates on small firm growth. International Small Business Journal, 39(1), 3-17. https://doi.org/10.1177/0266242620951718

The most recent data for each of these categories using the ONS Business Structure database for the 2020-23 period is shown in Table 1. The results clearly show that firms achieving these 'transitions' over a three-year period form a small proportion of the total private sector population of over 1.28 million employer enterprises in the UK.[9] More importantly, we know that once a firm qualifies for any one of these three categories, they do not always remain there, with the majority never having a 'scaling episode' again. What is important, however, is to understand the triggers for these episodes in the first place, and to identify the characteristics of those firms that record repeat episodes of scaling.

Table 1: Alternative firm growth metrics

Metric	Time Period	Denominator	Number	%
Start-ups scaling – 'Initial Scaling'	2020-23	154,297	3,049	2.0
Established Firms – 'Stepping up'	2020-23	72,201	4,963	6.9
Productivity Heroes	2022-23	783,353	73,040	9.3

Source: ONS BSD (2020-23)

Of the 325,811 start-ups registered in 2020, only 47 per cent survived to 2023, and of these only 2 per cent (3,049) managed to achieve £1m turnover after three years – a proportion that has remained constant over the UK in the last decade. Only in Northern Ireland has it consistently been higher at 3-4 per cent.

What is even more striking is that the median turnover of the remaining surviving start-ups was £100,000 which is around three times the average wage in the UK.[10] While this represents a significant income for the household and its financial independence, it does perhaps question the growth potential of the UK's start-up economy especially when the 10-year survival rates for start-ups are only 10 per cent.

Having got to over £1m turnover, how many established firms over three years of age then 'step up' and continue on a growth trajectory? The answer is 7 per cent, calculated by tracking all surviving firms in the £1-2m turnover category in 2020 to find out how many had over £3m by 2023.[11] This is broadly similar across the whole of the UK except Scotland where it has consistently been 5 per cent.

Previous ERC research has showed that there is a very poor correlation between jobs growth, increases in revenues and productivity gains in the UK business population. Most firms struggle to significantly increase turnover, jobs and productivity simultaneously, and crucially the analysis shows that the only 'space' where the growth in turnover, jobs and productivity are all positive is sparsely populated by firms accounting for less than one in ten of the surviving panel of firms.

Overall, 783,353 firms increased productivity (i.e., turnover per employee) in 2020-23 through many different routes, including the 74 per cent that increased their turnover and created zero jobs in the process as well as the 10 per cent that had also increased their turnover and shed jobs. Our metric focuses on what might be termed 'virtuous' or 'heroic' firms as they grew their turnover whilst also continuing to hire. These 73,040 firms created 285,579 jobs in a 12-month period (26.1%) and collectively increased their turnover by just over £110bn (61.4%) and as a result their productivity grew by 28 per cent. A third of these firms were in business and professional services, with a further 17 per cent in the wholesale and retail sector.

9 Of which, 1.23m are at least 3 years old.
10 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2024
11 This is exactly the same proportion as in the 2015-18 and 2017-20 periods so this is not simply a pandemic effect.

In a paper published this year we also explored trends amongst Productivity Heroes over time, with our analysis showing that since the year 2000, the number and proportion of Productivity Heroes in the UK has fluctuated, and that their growth was seriously affected by the Great Financial Crisis. Although since 2010 there has been a slow recovery in numbers, however, it remains the case that over time these firms have made up a very small proportion of the overall private sector business population.[12]

In summary, we can see that developing a range of growth, or 'scaling' metrics, and looking at these by sector and region, provides a more granular analysis into how the private sector is developing over time and how business support measures by the public and private sector may best intervene. Overall, it confirms that very few firms grow, and this remains a key challenge for the UK, and one the forthcoming Small Business Strategy to be published by the UK Government in the Spring of 2025 will need to address.

2.2 Business dynamism

Another dynamic of the UK economy that it will be important for the Small Business Strategy and future business support initiatives to understand is business dynamism – or the rates of job creation and destruction. The link between business dynamism and productivity growth at the national level is an empirically established fact that we have emphasised in previous ERC research. Despite the overall increase in both the number of firms and jobs across the UK and its regions since the start of the millennium, there is nevertheless evidence of declining business dynamism over almost all of this period.

Our latest analysis of the evidence on business dynamism for the UK uses the longitudinal enterprise-level Business Structure Database (BSD) over the last 26 years (from 1998-2023), to provide a summary of average annual rates of job creation and destruction, entry, exit and job reallocation rates in the UK disaggregated by regions. The key metrics are:

- Job Creation: The number of jobs created through firm entry and expansion
- Job Destruction: The number of jobs lost by firm exit and firm contraction
- Net employment: The net number of jobs by the end of the accounting year.

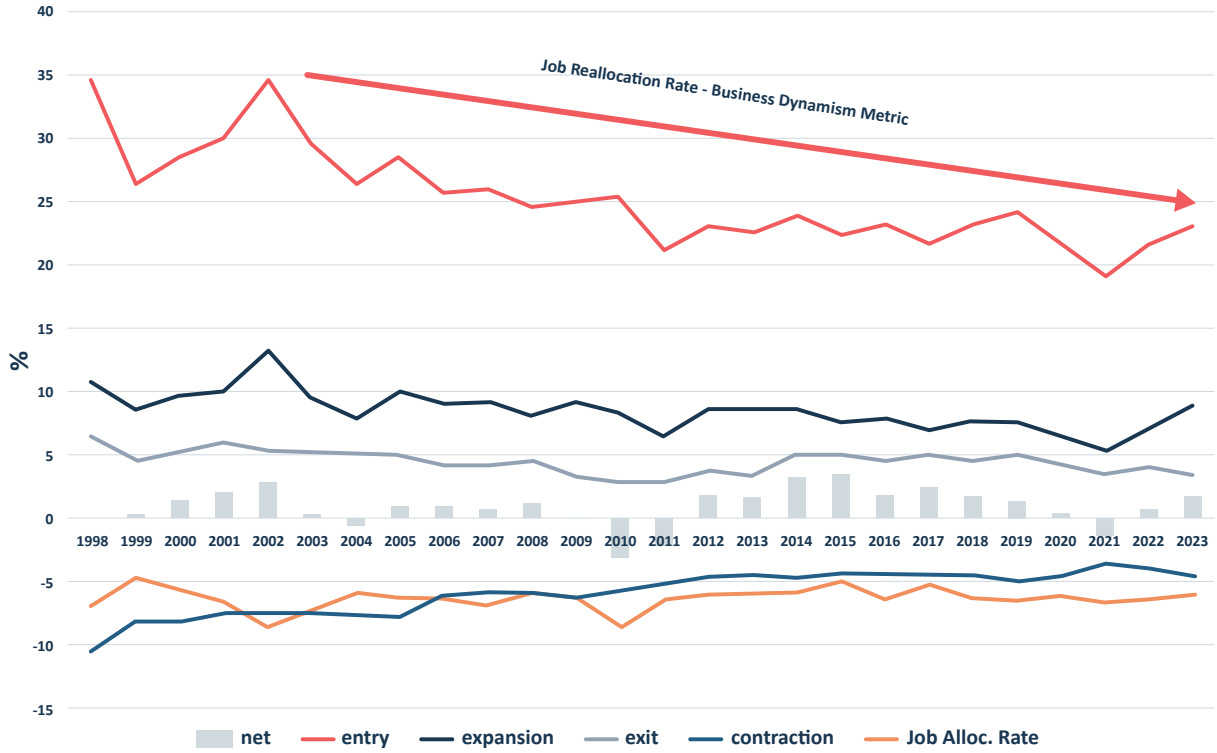
These job creation and destruction figures are expressed as the ratio of the total opening stock of employment in that accounting year. The change in employment between two years is often referred to as the net employment change. This is equal to the difference between job creation and job destruction over the period. The net employment rate is the job creation rate less the job destruction rate.

On the other hand, the sum of job creation (via entry and expansion) and destruction (via contraction and exit) expressed as a rate refers is referred to as the job reallocation rate. This measure summarises the overall volume of change, and essentially represents the reshuffling of job opportunities across regions (Davis et al., 1996).[13] This measure provides an indication of business dynamism.

Figure 8 shows the different components of job creation and destruction rates for the UK from 1998 to 2023. On average, nearly a quarter of jobs were either created or destroyed yearly, and the job reallocation rate has declined in the UK over time. Further, the creation of jobs through the entry of new firms accounts for only three per cent to five per cent of existing jobs, and notably the start-up led job creation rate has declined in recent years. This last point should perhaps introduce a reality check on the annual celebration of the record number of new business registrations.[14]

12 https://www.enterpriseresearch.ac.uk/publications/productivity-puzzles-long-tails-and-productivity-heroes-developing-a-new-focus-for-small-business-policy-in-the-uk/
13 Davis et al., (1996) Job Creation and Destruction, MIT Press: Cambridge Mass.
14 https://www.enterprisenation.com/learn-something/number-of-active-companies-in-the-uk-reached-record-high-in-2024/

Figure 8: Job creation and destruction in the UK (1998-2023)



Source: ONS Business Structure Database (1998-2023)

The job reallocation rate in the latest year (2022-23) is 22.5 per cent in the UK, and translates into 4.9 million jobs (Table 2). Job reallocation with considerable job destruction makes many workers move between jobs or face periods of unemployment, potentially leading to increased job insecurity and income volatility for a large portion of the workforce. Further, these losses may disproportionately affect certain sectors or regions, exacerbating existing inequalities.

Table 2: Job gains and losses in the UK (2022-2023)

	Job Gains	Job Losses
Start-ups	766,585	
Expansion	1,934,267	
Closure/Exits		966,961
Contraction		1,294,604
Total	2,700,852	2,291,565
Net Job Change	409,287	
Gross Job Churn	4,992,417	

Source: ONS Business Structure Database (1998-2023)

The key point to note is that there is an underlying level of turbulence in the private sector in periods of growth in the economy, and this is an important indicator of business dynamism. It is the balance of the components which is important, and the faltering level of job creation by start-ups and the rise in job losses in existing businesses coupled with low level of business dynamism and related effects on productivity are issues of concern in the current economic context.

2.3 Business investment decisions

One explanation that is often said to lie behind the UK's lagging productivity growth is the lower business investment rates found in the UK compared to other comparable economies. Given this is the case, it is perhaps surprising that the process of investment decision-making and the factors that influence it has been a neglected area of research.

In 2024 we published new research on this theme. We conducted a rapid literature review of peer-reviewed academic and grey literature focusing on the economic impacts of business investment and factors that affect it for Scottish Enterprise, and we also published a SOTA Review on what influences business investment.[15] [16]

These reviews explored two types of investment - tangible (capital investment) and intangible. Tangible investment consists of physical assets such as machinery, equipment, vehicles, etc., whereas intangible investment refers to non-monetary assets such as R&D, intellectual property, branding, marketing, staff training, etc.

The reviews identified several factors affecting firms' business investment decisions. These included firm size and exporting status - with larger business size and exporting activity being associated with higher investment. The financial health of the firm was another factor influencing investment, with financially better-off firms investing more in both tangible and intangible assets, as we might expect. Financial health is defined in a range of ways in studies, including cashflow, credit rating, indebtedness, as well as access to finance - the latter being particularly important for small firms.

Higher human capital - i.e., training, skills, knowledge, technical expertise etc., is also positively linked with business investment, particularly into intangibles. Better management practices are also linked to higher investment, in part because they enable firms to identify investment opportunities more effectively. Other factors such as firm level and macro-economic uncertainty, as well as public policy intervention and regulation also affect investment decision-making.

In addition, the literature highlights that the perceptions and motivations of business leaders also affect investment behaviour. A positive attitude towards business growth and specific investments makes decision makers more likely to invest. Whilst leaders and managers seem to be the primary decision-makers, it is also the case that a number of different internal and external stakeholders have a role in the investment decision-making process, as well as the history of investment decisions within firms.

Overall, the evidence reviews showed that a range of internal and external factors affect business investment. There is scope for further research, particularly around understanding how motivations vary between different firms, what shapes this motivation, and the ability of business leaders to make productivity-related investments. We are currently undertaking a large-scale survey and in-depth company studies aimed at examining business investment decision-making, with results expected in 2025.

Alongside this research on business investment decisions, we also published research in 2024 on exploring the factors affecting firm decisions to export.[17] The productivity benefits of exporting are well-recognised, but whilst key firm characteristics related to export entry have been well studied, less attention has been paid to the factors that affect firm decisions to export, especially when it comes to re-starting and continuing exporting.

15 https://www.enterpriseresearch.ac.uk/publications/business-investment-drivers-barriers-and-economic-impacts-a-rapid-literature-review/
16 https://www.enterpriseresearch.ac.uk/publications/what-do-we-know-about-factors-that-affect-business-investment-decisions/
17 What do we know about the factors that affect business export decisions? - Enterprise Research Centre

A range of factors affecting firms' first-entry decisions were identified. First, leadership characteristics and perceptions were important – with greater knowledge and experience, more years of education, as well as experience of working in multinational companies and working abroad all having a positive impact. Studies have also highlighted the positive effects of foreign-born or immigrant business leaders on exporting decisions.

Second, the financial situation of the firm is also influential. The evidence shows that businesses in better financial health are more likely to start exporting. Third, connections and networks also positively affect export entry decisions, as does digital technology adoption, especially having a website. Export re-entry decisions were linked to exit decisions and prior export experience: in other words, firms learn from their exit experiences, which might lead them to change their strategy when re-entering. Export persistence was associated with similar factors as re-entry, particularly the financial health of the firm, alongside better export performance.

Together, these insights on the factors affecting investment and export decision-making provide useful insights for policymakers interested in designing support targeted at improving firm level productivity.

2.4 Summary

Over the years, ERC research has raised awareness of the complex patterns of small business growth, and the multiple challenges involved in achieving productivity growth. This year our research has provided more evidence illustrating the fact that only a minority of small firms achieve significant growth, and an even smaller proportion are able to significantly increase turnover, jobs and productivity simultaneously. These realities of growth patterns highlight the risks involved in focusing enterprise policy on a small group of exceptional high growth firms.

However, this is not to say that we cannot learn from our high performing firms such as those we have defined as Productivity Heroes, or that we can't create better conditions for business investment, or provide support that enables more business leaders to identify and realise their growth opportunities. For this a healthy business ecosystem is crucial, and we turn to this theme in the next chapter.

3. The Small Business Ecosystem

Small business growth and productivity depends on a healthy underpinning ecosystem - or the wider network of institutions, organisations and individuals that work together to support business survival and growth. ERC research has explored a variety of aspects of the small business ecosystem, and in 2024 we added further insights to this evidence base, particularly through our contributions to the Global Entrepreneurship Survey, and on the topic of business support.

3.1 Entrepreneurship framework conditions

The GEM Global study has created a tool that enables an assessment of an economy's entrepreneurial ecosystem against nine so-called Entrepreneurship Framework Conditions (EFCs). To provide an overall view of how favourable an environment is for entrepreneurial activity across countries, GEM introduced the National Entrepreneurship Context Index (NECI) in 2018, which is assessed by national experts.

The picture for the UK presented in the 2023/24 GEM Global report is concerning.[18] In the 25 years that the GEM UK team has been collecting the views of national experts, the most disturbing conclusion to be drawn is that many of the deficiencies they were identified with the entrepreneurial ecosystem at the start of the millennium remain today. Entrepreneurial education post-school continues to remain a challenge despite numerous public and private initiatives to address this important weakness in the UK.

Since the pandemic, the UK has been part of an increasing group of high-income economies with an assessed overall entrepreneurial environment that has slipped from sufficient to less than sufficient. The scores for the two different entrepreneurial finance EFCs have fallen over the last three years, which is surely a major concern for a leading international finance centre. Further, there has been a weakening in a number of the EFCs, most notably in the availability of sufficient entrepreneurial finance, government policies around business support, and physical infrastructure.

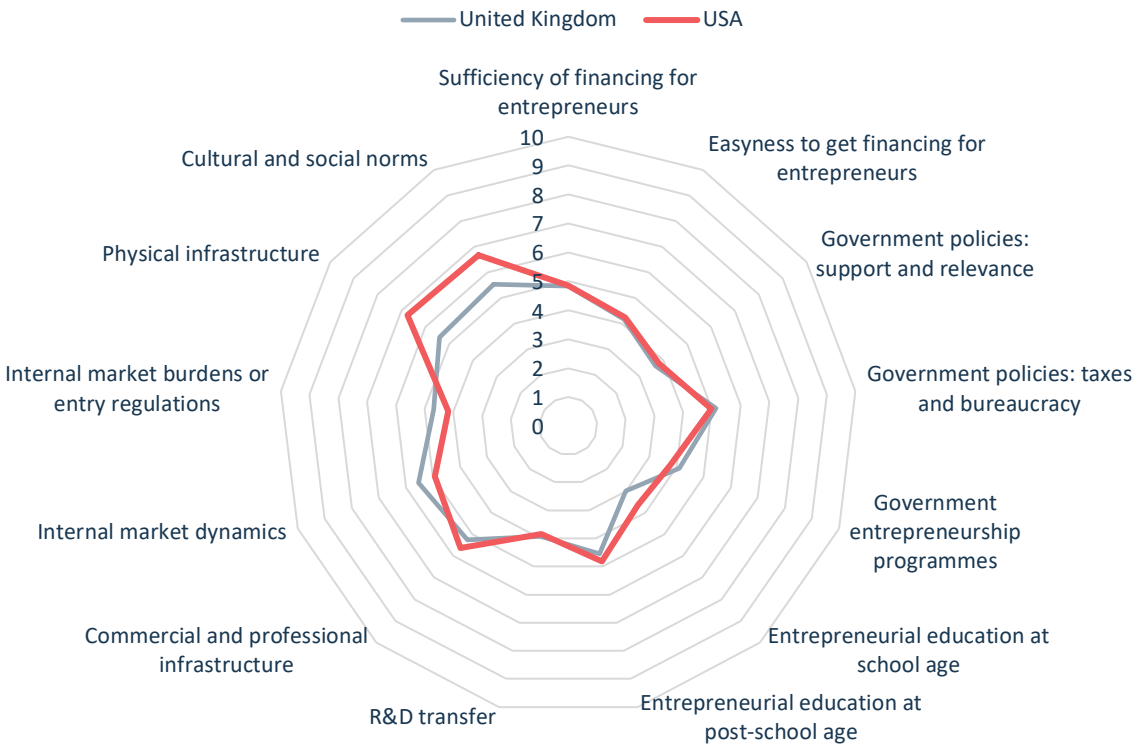
Looking at the detail, the GEM report notes that in 2020, the overall quality of the UK entrepreneurial environment (measured by the NECI), was rated as satisfactory, with a score of 5.0. Since then, the UK's score has declined slowly, sitting at 4.6 in 2023. This placed the UK at 22nd of the 49 economies participating in the survey, with a score that has slipped from sufficient to less than sufficient.

There were small declines in nine individual EFC scores for the UK since 2022, compared to increases in just four. The UK's scores for the two entrepreneurial finance EFCs fell over the last three years (entrepreneurial finance provision, and ease of access to finance), with both rated less than sufficient in 2023. Social support for women entrepreneurs was rated as much less than satisfactory at 3.2, ranked 36th of 49 economies. Access to resources for women entrepreneurs relative to men on the other hand was more positive, and had a score of 5.8, which was 10th highest.

As Figure 9 shows, the UK framework conditions mirror again relatively closely the US EFCs For six pillars, scores are higher in the UK and for other seven - lower compared to the US, however these differences are not statistically significant.

18 GEM 2023/2024 Global Report: 25 Years and Growing

Figure 9: EFCs in the UK and benchmark countries in 2023



Source: GEM NES 2022
Note: EFCs scale: 0 = very inadequate, insufficient status; 10 = very adequate, sufficient status;

It is perhaps easy to explain the decline in the UK's EFC scores terms of the combined effects of the pandemic, Brexit, and the Ukraine war. However, the fact that other European countries, such as the Netherlands and Estonia, have continued to improve their entrepreneurial ecosystem despite these challenges means that the UK needs to engage with the home-grown nature of these deficiencies and address them as a matter of priority.

Our research also enables us to take a closer look at some of the detail contained in the most recent GEM UK report regarding Entrepreneurial Framework Conditions across the UK nations. In 2021 we conducted the GEM National Expert Survey (NES) in Northern Ireland and Scotland to sit alongside the overall UK analysis for the first time. In 2023, we repeated this analysis to have a better understanding of how the entrepreneurial environment changed for the UK over time, but also in the two of the home nations.[19]

In both Scotland and Northern Ireland, the overall 2023 National Entrepreneurship Context Index (NECI) scores were lower than 2021, bringing them further below the sufficiency level. The decline is particularly alarming in Northern Ireland, where the score fell by almost 15 per cent from 4.95 to 4.23 (Table 3). This reflects a deterioration in all 13 EFCs, with the most dramatic fall related to government policies to support new and growing ventures (28% decrease), entrepreneurial education at school age (21% decrease), but also cultural and social norms (20%).

19 See Section 8 in the GEM UK National Report 2023/24: https://www.enterpriseresearch.ac.uk/wp-content/uploads/2024/07/12828-%E2%80%A2-GEM-UK-23-24-WEB-READY-22.07.24.pdf

In Scotland, the overall NECI score slipped by only 1.5 per cent, from 4.98 in 2021 to 4.91 in 2023 due to positive dynamic of eight EFCs counteracting a decline in the others. Contrary to the UK overall, experts evaluated positively the availability of sufficient entrepreneurial finance (5.04), the ease of getting finance (4.76) improving, although not yet reaching the sufficiency threshold. Improvement was also observed in the assessment of infrastructure, both physical and commercial, internal market dynamics and market entry regulations, as well as cultural and social norms. However, scores for government policies fell for all three dimensions of government policies, including entrepreneurship programmes, which is in line with the overall UK dynamic.

Table 3: EFCs in the UK, Scotland and Northern Ireland in 2021 and 2023

EFCs / NECI	United Kingdom			Scotland			Northern Ireland		
	2021	2023	dynamic	2021	2023	dynamic	2021	2023	dynamic
Sufficiency of financing for entrepreneurs	5.15	4.83	↘	4.83	5.04	↗	4.48	4.09	↘
Easiness to get financing for entrepreneurs	4.36	4.16	↗	4.74	4.76	↗	4.41	3.88	↘
Government policies: support and relevance	4.23	3.66	↘	4.86	4.77	↘	5.37	3.88	↘
Government policies: taxes and bureaucracy	5.59	5.15	↘	5.43	5.15	↘	5.68	5.11	↘
Government entrepreneurship programmes	4.32	4.1	↘	5.8	5.32	↘	5.67	4.77	↘
Entrepreneurial education at school age	3.2	3.01	↘	3.36	3.37	↗	3.56	2.83	↘
Entrepreneurial education at post-school age	4.96	4.55	↘	5.12	4.68	↘	4.96	4.14	↘
R&D transfer	4.21	3.93	↘	5.1	4.77	↘	5.11	4.21	↘
Commercial and professional infrastructure	5.84	5.26	↘	5.58	5.63	↗	5.66	4.76	↘
Internal market dynamics	4.94	5.53	↗	4.49	4.73	↗	4.59	4.43	↘
Internal market burdens or entry regulations	5.51	4.69	↗	4.8	4.83	↗	4.45	4.36	↘
Physical infrastructure	6.53	5.4	↘	5.71	5.78	↗	6.11	5.09	↘
Cultural and social norms	5.34	5.54	↗	4.98	5.05	↗	4.38	3.5	↘
NECI	4.94	4.60	↘	4.98	4.91	↘	4.95	4.23	↘

Source: GEM UK, NI and Scotland NES Surveys 2021

3.2 Access to finance

Seeking and obtaining external finance (debt and equity) is positively associated with faster growth and productivity in SMEs, although previous ERC research has shown that most small businesses in the UK can be classed as permanent 'non-borrowers'.

The financing of early-stage businesses in particular is notoriously difficult, associated with the high risks involved. However, it is important that the UK has a pipeline of new business ventures, and that many of these are innovative, and have growth potential. In 2024 we published some new research examining access to and use of equity finance amongst UK early-stage ventures.[20]

Equity finance - where venture owners give a share of their business in return for funding from an investor - provides an important alternative to bank debt finance. This is especially important for innovative ventures that are pre-revenue and lack a financial history. Our research involved the first national survey looking into the process of how potential high growth start-up businesses access their first formally reported round of equity finance. Prior to this survey, UK evidence was only available for those ventures that were successful in obtaining equity finance, leaving a gap in knowledge about those that were unsuccessful. With the British Business Bank's Small Business Equity Tracker 2024 showing that equity investment for smaller businesses has fallen to 2019 levels (with a 48% decline in annual equity investment in 2023), the survey provides much-needed evidence.

The findings show that equity finance is very important for early-stage innovative companies. The survey covered 727 UK start-ups interviewed between January and June 2023, and found that early-stage markets are well supplied by a wide range of investors, with funding most frequently coming from business angels, venture capitalists and crowdfunders. Overall, around 62.6 per cent of respondents were using external finance 12 months before the survey, equity was the most commonly used source of funding among responding ventures, being used by 45.8 per cent of firms.

The journey to accessing equity finance is often long and difficult. One third of firms had sought equity finance during the past year (2022-23), but only half of these were receiving any finance (with the average amount of their finance being only two-fifths of their application requirement), and this was typically after making multiple (five or more) applications. Rejection was most common either at the stage of initial or multiple presentations with investors. The main consequences of not obtaining equity funding were said to be slower market introduction of new products/processes, slowed technology development and limited business growth.

A lack of prior experience in using equity finance, as well as inadequate access to external assistance were all factors in lower application rates, whilst on the other hand, productive higher capital expenditure start-ups were more likely to apply for finance. Equity applicant success rates were significantly advantaged by a prior track record of using equity, and being in revenue significantly increased the percentage of equity finance required that was raised. Being located in London and the South East also increased the probability of seeking equity by 7.1 per cent.

The research points to some important policy recommendations, which may help overcome geographical disparities in equity finance, and assist start-ups which have long research and development period before commercialisation. These recommendations include: continuing to provide the Seed Enterprise Investment Scheme (SEIS) tax break, but adjust this to support longer horizon research and development businesses; enhancing public-private co-financing, ensuring that the loss of former European Union investment funds are replaced; ensuring that investment support programmes are reaching across all of the UK regions; enhancing national grant programmes like the Energy Entrepreneurs Fund to assist long horizon R&D sectors; further support for UK University equity seed funds.

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20 Understanding equity access and use in early-stage ventures - Enterprise Research Centre

3.3 Business support

The provision of business support and advice is a key part of the small business ecosystem, playing an important role in business survival and growth. ERC research has filled several evidence gaps on the links between business support and small firm performance. New research published in 2024 added to the mounting evidence on this link, all analysing data from the Longitudinal Small Business Survey (LSBS), with mixed findings.

One paper estimated the impact of formal business advice interventions on employee productivity, also exploring the impacts of different advice topics to identify those more likely to enhance productivity.[21] LSBS data from the years 2015 to 2021 was analysed, and the findings showed that in general accessing business advice raises productivity by 10 per cent. Looking at specific topics, the most sizeable improvements were for advice that was focused on more 'codified' knowledge delivered by trusted professional practitioners. In particular, advice about exporting (35.3% productivity increase), tax/national insurance law and payments (26.3% productivity increase), legal issues (21.0% productivity increase), and regulations (17.0% productivity increase) had the most marked effects.

Another report examined the impact of both day-to-day (operational) and more strategic (growth-oriented) advice on firm-level innovation and productivity.[22] Using LSBS data from between 2016 and 2022, the research matched enterprises that used external advice to enterprises that did not use external advice (and were never observed to do so), based on a range of characteristics, including whether they operated more than one site, age, region and industry.

The findings of the study were striking, showing that firms that used external advice saw an average increase in their labour productivity by 22.1 per cent compared to firms that did not use external advice. Furthermore, the analysis shows that accessing business advice improved firm performance on a number of different outcome measures, including innovation and productivity. Taking a combination of both day-to-day and strategic advice enhanced productivity, but for the most innovative firms, strategic advice was the critical factor enhancing performance. The authors conclude that: 'Strategic advice appears to play a central role in unlocking the innovative potential of firms which then ultimately leads to significant productivity enhancing behaviours. This type of advice appears to play a critical role in mitigating some of the uncertainty and ambiguity confronting entrepreneurs when making critical decisions about a firm's long-term strategic plans.'

Another paper published in 2024 used the LSBS to examine the links between business support, management practices and performance. This study looked at firms receiving business support in 2018, the managerial practices they implemented in 2019, and firm performance (turnover growth and employee growth) in 2022.[23] This study reveals that although business advice and the use of government grants enhanced the likelihood of adopting managerial practices, the effects on firm performance were marginal. The authors suggest that the impact of business support on performance is lagged, as SMEs require time to implement the support before observing any noticeable improvements.

Other research this year also explored another dimension of business support - the relationship between diversity, business advice, and innovation outcomes.[24] Using new data from the UK Innovation State of the Nation Survey (ISNS 2023), our study looked at whether diversity in leadership teams influences the willingness of a firm to seek external business advice, and the ability to benefit from that advice. The study found that both gender and ethnicity diversity in leadership are positively associated with a higher likelihood of a firm seeking external advice. In addition, when firms seek external advice, they significantly and consistently outperform their non-advice-seeking counterparts in product and process innovation, with stronger effects for product innovation. The effect of advice on innovation becomes stronger as firms gravitate towards gender-balanced and ethnic-balanced management. The conclusion drawn is that gender

21 https://www.enterpriseresearch.ac.uk/publications/what-kind-of-business-advice-improves-small-business-productivity/
22 Advice and SMEs: Who Takes it and What Happens Thereafter? - Enterprise Research Centre
23 The relationships between business support, managerial practices and firm performance over time - Enterprise Research Centre
24 Leadership diversity, business advice and firm-level innovation outcomes - Enterprise Research Centre

and ethnic diversity in leadership have a twin effect on business advice and innovation. Greater diversity means firms are more likely to seek advice, and when they do, greater diversity means advice provides stronger innovation benefits.

Finally, business support was the main theme of the State of Small Business Britain conference this year, with many additional insights shared on the day by speakers and delegates.[25] One point that recurred throughout the discussions was the need for consistency of provision and to tackle the existing fragmentation in the support landscape - providing a clear 'front door' for business support that is easier for small businesses to navigate. This is also a key area for action we identified in our manifesto for small business growth and productivity, and the central point made in a blog post authored by Kevin Mole emphasising that SME policy must involve consistent institutions, because longevity is an element of successful business support.[26]

Several other useful points emerged through the State of Small Business Britain conference discussions about what makes successful business support, including: The importance of getting the focus of business support programmes right - and the difficulty of achieving growth in turnover, jobs and productivity all at the same time; The need to properly understand the realities and challenges of running a small business and embedding this in programme design and delivery; The importance of identifying, nurturing and encouraging the capabilities and ambitions of business leaders; The crucial role played by skilled business advisers and the importance of establishing relationships of trust between businesses and advisers; and the value of peer networks and of nurturing ongoing communities of support beyond initial support programmes.

3.3 Summary

There is strong evidence that several elements of the small business ecosystem in the UK are in need of improvement, especially in the areas of finance and business support. This year ERC research and analysis has added more insights in this area with some useful policy implications.

The GEM survey findings show that the UK compares poorly with many similar economies in terms of its entrepreneurial ecosystem, with expert assessments of conditions slipping since the pandemic. Access to finance remains a major, stubborn problem in the UK, and research this year has illustrated the difficulties involved in accessing equity finance in particular. ERC research published in 2024 has again demonstrated the positive effects business support can have on small business performance. Furthermore, it has also highlighted the specific types of support that could have the most benefit. However, the system of business support and advice in the UK at the current time is fragmented, imbalanced and patchy. It is vital that the UK's weaknesses in this area are addressed as a matter of priority in 2025.

25 The State of Small Business Britain Conference Report 2024 - Enterprise Research Centre
26 Two critical reasons why SME policy must involve consistent institutions

4. Innovation

Innovation, broadly defined as the introduction of new products, services, and ways of doing business, is a central research theme at the ERC. In 2024 we developed the evidence base further, exploring key trends in innovation activity, the pathways by which innovation is linked to growth and productivity, issues around the adoption of digital technology and net zero practices, and the impact of innovation support.

4.1 Trends in innovation activity

ERC research has deepened understanding about the trends and patterns in innovation activity in the UK and how this compares internationally. Our Innovation Benchmarks reports have also drawn attention to the innovation geography within the UK, for example identifying high levels of innovation activity in an 'arc of innovation' in the South and East Midlands and along the M4 corridor.[27]

Survey evidence shows that innovation activity in firms is sensitive to economic shocks. ERC analysis of the UK Innovation Survey for example has showed that there was a steady increase in the proportion of UK firms undertaking new-to-the-market or radical innovation before the financial crisis of 2008, however, the proportion of firms engaging in new-to-the-market innovation fell back during the recession, although the proportion engaging in 'imitation' (or new-to-the-firm innovation) increased sharply. This suggests that when the uncertainty in the business environment increases firms tend to engage in more conservative forms of innovation behaviour.[28]

The Covid-19 pandemic also had an impact on innovation behaviour. In May 2022, the results of the UK Innovation Survey (UKIS), covering firms' innovation activity during 2018-20 were published. This survey suggested that there had been an increase in the overall proportion of UK firms which were classed as 'innovation active' before the pandemic struck.

In 2024, the latest results of the UKIS were published, covering the years 2020-2022.[29] The results found that 36 per cent of UK businesses were innovation active, which represents a sharp decrease compared to the 45 per cent in the 2018-2020 period. Large businesses were much more likely to be innovation active than smaller ones. In 2020-2022, the UKIS found that 50 per cent of large businesses were innovation active, compared to just 36 per cent of SMEs. The UKIS also suggests an increasing gap between the proportion of larger and smaller firms that are innovation active.

As noted in Chapter 1, the findings from the most recent LSBS panel survey also indicate that small businesses are innovating less. The proportion of SMEs in the panel reporting either product or service innovation was 32.2 per cent in 2020, but fell year-on-year to 30.6 per cent in 2023.[30]

In 2020, the ERC and the Innovation Caucus were commissioned by Innovate UK to undertake a large-scale longitudinal survey assessing the impact of Covid-19 for current and future innovation behaviour amongst Innovate UK award holders - the Innovation State of the Nation Survey (ISNS). Several waves of this survey (covering approximately 2,000 firms annually), have now been undertaken, with the most recent published in 2024.[31]

27 https://www.enterpriseresearch.ac.uk/publications/benchmarking-local-innovation-the-innovation-geography-of-england-2016-18/
28 https://www.enterpriseresearch.ac.uk/publications/innovation-imitation/
29 https://www.gov.uk/government/statistics/uk-innovation-survey-2023-report/united-kingdom-innovation-survey-2023-report
30 https://www.gov.uk/government/statistics/small-business-survey-2023-panel-report/small-business-survey-2023-panel-report#trends-in-the-drivers-of-sme-growth
31 https://www.enterpriseresearch.ac.uk/publications/insight-from-innovation-state-of-the-nation-survey-isns-2023-and-2024/

Earlier waves of the survey carried out in 2020 and 2021 suggested that the pandemic had a significant short-term negative impact on R&D and innovation amongst innovative firms, and the 2022 survey found that firms were continuing to experience significant disruption. The latest report brings the story up to date, based on data collected in early 2023 and 2024.

In 2024, 56 per cent of the businesses surveyed reported making product or service changes over the last year. Reflecting the longer-term trend in the UK Innovation Survey, this is a fall from 61 per cent in 2023. Again, reflecting longer-term trends, it is also notable that innovation rates fell most in small and micro-businesses between 2023 and 2024. For instance, there was a 6.2 per cent decrease in the rate of innovation activity in small firms compared to a 0.4 per cent fall amongst large firms.

In the ISNS survey, an 'innovation active' firm is defined as one engaged in R&D, product, service, process, or organisational innovation or one that has either been actively engaged in or abandoned innovation in the last three years. The survey also distinguishes between frontier and non-frontier firms, with frontier firms defined as those leading their sectors in terms of technology, with non-frontier firms defined as followers.

In terms of trends in the nature of innovation activity, overall, 39 per cent of firms reported engaging in some form of R&D activity in 2023, which remained the same in 2024. However, there was a significant difference between large and micro-firms here. In 2023, 80 per cent of large firms with more than 250 employees engaged in some form of R&D activity, while only 34 per cent of micro-businesses invested in R&D. While the proportion of large firms engaging in R&D activities remained stable in 2024, the proportion of micro-firms engaging in R&D dropped by three per cent in 2024. Looking ahead, 47 per cent of UK firms said that they planned to invest in R&D over the next 12 months, a decreased proportion compared to 2023. This declining trend was particularly significant in small firms and non-frontier firms.

Comparing 2023 and 2024, there was a three per cent decline in the proportion of innovation active firms that reported that some of their innovations were new-to-the-market and a one per cent decline in the proportion of firms that reported wholly new-to-firm innovations. There was also a decline in the proportion of firms introducing process innovations. In 2023, 46 per cent of firms reported process innovation, while only 41 per cent reported this in 2024. Declining rates of process innovation were notably higher for micro and non-frontier businesses. Micro-businesses that undertook process innovation decreased from 42 per cent to 34 per cent, while non-frontier businesses that undertook process innovation decreased from 43 per cent to 36 per cent.

The ISNS also includes questions on the broader range of organisational changes to business practices, work organisation, organising external relationships and marketing strategies. The findings here show a mixed pattern in business model innovation. The proportion of firms that undertook changes in business practices, work organisation, and organisation of external relationships fell by one per cent, three per cent, and one per cent respectively in 2024. Meanwhile, the proportion of firms that undertook changes in marketing strategies increased by three per cent in 2024. Business model innovations were generally more common among frontier and large businesses, whilst micro/small and non-frontier firms drove the increase in marketing innovation.

Turning to look at collaboration, overall, the proportion of firms collaborating with external partners on innovation decreased from 41 per cent in 2023 to 39 per cent in 2024. However, this pattern varied between groups of firms and there were changes in the types of collaboration undertaken. For example, while collaboration activities decreased by around 3 per cent among non-frontier and smaller firms with less than 250 employees, they increased by 3-4 per cent among frontier firms and large firms with more than 250 employees.

4.2 Innovation and performance

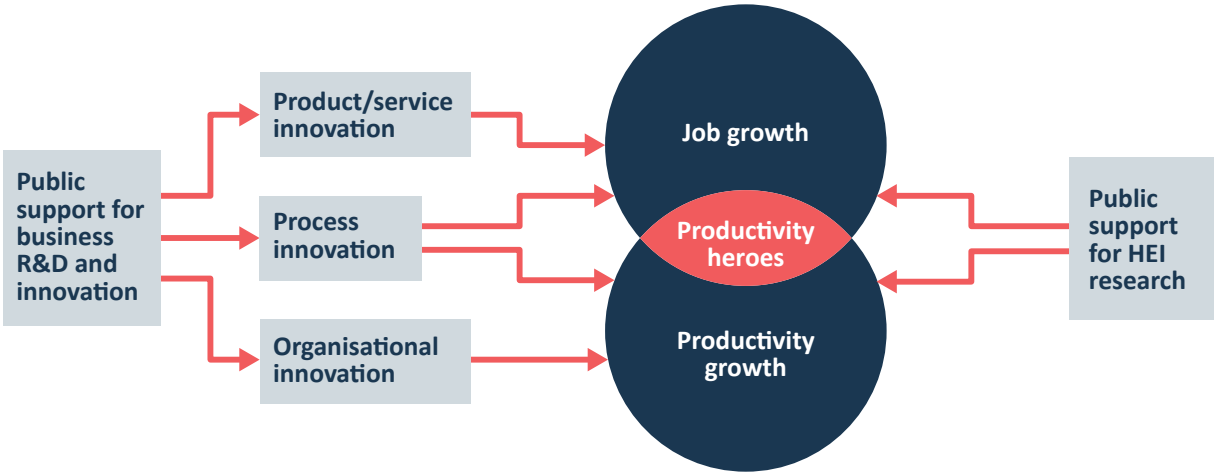
A substantial body of ERC research has drawn attention to the links between innovation and business performance, and new research published in 2024 adds to this knowledge base.

The findings from the latest Innovation State of the Nation Survey report provide additional evidence that suggests that innovation is strongly associated with higher sales growth. For instance, in 2023, the sales growth of innovating firms was 10 per cent compared to three per cent for non-innovating firms. In 2024, the gap narrowed slightly, with innovating firms growing around seven per cent compared to two per cent for non-innovators.

However, the links between innovation and performance are not clear cut, a fact that has been highlighted by previous ERC research. In 2024, we published a new paper that aimed to provide a clearer picture of the pathways through which investment in R&D, and the innovation that results from this, can contribute to productivity and growth, drawing on previous data analyses.[32] The paper explores the differential impacts of privately and publicly funded R&D, the pathways from R&D to different types of innovation (e.g., product/service, process, organisational change) and how this can influence productivity and job growth. This is done using a 'value chain' approach linking R&D spending to innovation, and so to business growth and productivity.

The paper emphasises the complexity of these pathways, and the ways in which various types of funding and innovation impact aspects of business performance differently, as shown in Figure 10 below. The figure illustrates that the direct effects from public support for R&D and innovation, illustrating the weaker effects on process compared to product/service innovation. It also shows that the effects from product/service innovation seem stronger on growth than on productivity. Process innovation, and to some extent organisational innovation, seem more likely to support productivity heroes and productivity growth. Public support Higher Education Institution (HEI) research also has strong job growth effects but there Is less evidence of any strong effect on productivity.

Figure 10: Linking R&D, innovation and business performance



There is evidence that businesses that receive public support for innovation innovate more, and that this can lead to improved performance. Previous ERC research has made a significant contribution to knowledge in this area. In 2017, for example, the ERC published a ground-breaking comprehensive assessment of the impacts of public research grants from UK Research Councils (including Innovate UK) on firm performance. The study found that firms who participated in research projects funded by UK Research Councils grew

32 R&D and innovation pathways to business productivity and growth: What does the evidence suggest? - Enterprise Research Centre

their turnover and employment faster in the years after the projects compared to similar firms which did not receive support. Previously other ERC research has found similar results, for example finding a strong positive effect on the employment and turnover growth of firms engaging with Catapult centres.[33]

However, only a minority of businesses receive such support. The 2023 UK Innovation Survey found that around four per cent of businesses reported receiving financial support from UK central government for innovation activities, compared to six per cent receiving support in the 2021 survey. Around one per cent of businesses received direct financial support (e.g., through R&D grants, working with Catapult centres), and four per cent received indirect financial support (such as R&D tax credits).

4.3 Innovation drivers and barriers

ERC research has provided many insights into what drives and inhibits innovation in small firms, identifying a wide range of factors involved, both internal - such as the use of R&D and intellectual property protection, management and leadership, business orientation, workforce diversity and other firm characteristics such as family ownership, and external - such as use of support, collaboration and 'openness', or the purposive links formed between firms and their collaborators and other ecosystem factors.

The latest findings from the Innovation State of the Nation Survey provide up to date insights here on the experiences of firms. Just over half of all innovating firms in the survey reported factors which had constrained their innovation activities. The after-effects of the Covid-19 pandemic (cited by 53.8%) and the cost of doing business crisis (cited by 51.0%) were the most common barriers experienced by innovating firms. Other factors playing a significant role in constraining innovation were: regulations and legislation (39.5%); uncertain demand (38.2%); lack of skills (35.4%); lack of government support (30.9%); and lack of finance (30.4%). Among those firms experiencing recruitment issues it was difficulties recruiting technicians (31.2%), engineering staff (20.9%) and graduate-level technicians (18.6%) which were the most common.

However, the findings indicate that barriers may be decreasing overall. Around 46 per cent of firms in the ISNS reported barriers to their innovation activities in 2024 compared to 52 per cent in 2023. However, there was variation here depending on the nature of the barrier. There was a significant increase in the proportion of innovating firms that reported barriers due to a lack of government (which increased by 9% in 2024), lack of finance (which increased by 8% in 2024), and technology risk (which increased by 8% in 2024). By contrast, overall, 32 per cent of UK businesses indicated that recruitment issues had restricted their innovation activities in 2024, a decrease from 39 per cent in 2023.

For non-innovating firms, the most common reasons for not undertaking innovation over the past two years relate to adequate profitability (44% in 2023 and 42% in 2024) and uncertain demand (43% in 2023 and 41% in 2024). Interestingly, more non-innovating firms reported barriers to innovation due to a lack of finance, government support, and regulation/legislation in 2024 than in 2023.

In 2023 and 2024, internal funding remained the most common approach to funding R&D and innovation. The proportion of firms that used internal funding increased from 67 per cent in 2023 to 70 per cent in 2024, and was notably higher among smaller businesses and frontier firms.

33 Evaluating the medium-term business performance effects of engaging with Catapults: A propensity score matching - difference-in-difference study - Enterprise Research Centre

4.4 Innovation advice and support

Data from the latest ISNS gives useful insight into the support needs and activity amongst innovative firms. The findings show that overall, the proportion of innovative businesses seeking external advice on innovation remained the same over the last two years, at around 35 per cent of firms surveyed. The most common types of support sought related to running and growing the business: other types of support - for example associated with digital technologies, product and service innovation, and net zero - were sought less often, but were more likely to be sought by frontier rather than non-frontier firms.

The survey also found that innovative firms expect to need/demand more innovation support over the next year. They said that they are more likely to seek business development support (14%) than product/service development support (10%). Firms also reported a need for more financial support over the next 12 months. The proportion of firms reporting a need for innovation loans increased from 17 per cent in 2023 to 30 per cent in 2024. Similarly, the stated need for support through R&D grants, R&D tax credits, IP support, marketing/export support, strategy advice, and finding innovation partners increased by more than 20 per cent in 2024.

New research published in 2024 explored innovation ecosystems in different UK home nations. One of these studies involved a detailed mapping of the support measures for R&D and innovation available to firms in Northern Ireland, and also included comparisons with selected benchmark countries.[34] The study found that Northern Ireland has a wide range of existing support measures for R&D and innovation, and where firms are supported by these schemes, the evidence suggests they significantly boost future business growth. The research made several other observations on the situation in Northern Ireland in terms of innovation activity and support. The analysis showed an emphasis on product/service innovation, with less focus on process and organisational change in firms, and the presence of a complex R&D and innovation support landscape given the availability of regional, national and cross-border support measures. Taking into account the international comparisons, the study also concluded that the international landscape for R&D and innovation is changing rapidly, leading to a reorientation of policy rationales from addressing market failures to a more strategic approach of supporting policy missions.

Another study published in 2024 focused on high-R&D intensity firms in Wales, exploring the contribution that these firms make to employment and turnover.[35] The research involved a bespoke analysis of firm-level survey and administrative data alongside in-depth company interviews. The study found that the innovation Welsh firms are undertaking differs somewhat to that elsewhere in the UK with a stronger focus on product/service innovation and less focus on process innovation. The research revealed that levels of university collaboration were also lower than those found in some other parts of the UK, notably Scotland. These lower levels of collaboration combine in some of the companies interviewed with a strong reliance on internal funding for innovation and limited engagement with potential sources of public funding. These factors suggest a more ‘closed’ rather than ‘open innovation’ model, and this may be limiting firms’ ability to share the costs and risks of innovation.

34 R&D and Innovation support in Northern Ireland - Enterprise Research Centre
35 R&D-intensive businesses in Wales: Innovation and contribution to turnover and employment - Enterprise Research Centre

4.5 Digital and net zero adoption

In the past few years ERC research has taken forward understanding of the adoption of digital technologies and net zero practices in small businesses, recognising both have links with productivity and sustainable growth.

Research published in 2024 has further extended knowledge in this area. One paper explored disparities in digitalisation among UK SMEs focusing on variations by gender, ethnicity, region, and industry.[36] The study analysed LSBS data from 2018 to 2022, and a panel discussion with academics, small business owners, and industry experts. The adoption of five different technologies was explored. The research found a high adoption rate for accountancy software, whilst Artificial Intelligence (AI), robotics, automation, and VR/AR technologies had the lowest adoption rates. Male-led businesses consistently showed higher adoption rates for AI, Robotics, and VR/AR technologies compared to female-led businesses. Regional disparities were also evident, with London and the South East leading in AI, robotics, and VR/AR adoption, and significant growth observed in London, the West Midlands, and the South East since 2021. The findings suggest the need for targeted strategies to address disparities and promote more inclusive digitalisation.

The growth of AI presents challenges and also opportunities for small businesses. Another study published this year explored the adoption of AI in rural SMEs in particular, with a concern for the wider implications for rural economies.[37] The paper acknowledges that there is a well-known rural-urban divide in terms of technology access and adoption, and that this extends into innovation within firms, with rural firms tending to undertake less innovation. In this context, the growth of AI could present a significant threat, further widening the digital divide. The study profiled the rural SMEs adopting AI, and explored the reasons for adoption, along with the future intentions of firms.

The study found several factors linked to AI adoption in rural firms, these were greater turnover, a higher likelihood of employing staff, and greater numbers of employees. It was also the case that rural SMEs that had adopted AI had higher levels of male owner/directorship. Most SMEs in rural areas who had adopted AI were looking to expand, grow and to export, rather than reduce their workforces. It also revealed that seeking the use of formal networks was essential in driving adoption of the technology - noting that this is something that may be more challenging for rural firms due to their geography and reduced digital connectiveness. It is also important to note that although the application of digital technologies is associated with higher growth and productivity, there are also increased risks for firms. Cyberspace has transformed the crime environment for businesses, with official data showing that some 50 per cent of businesses experiencing a cyber security breach or attack during 2023. In an ERC SOTA Review published in 2024, we explored the evidence on the factors that are related to cyber security breach and attack and the key cyber security challenges faced by firms, particularly smaller firms.[38]

The literature identifies a number of factors linked to cyber security breaches and attacks, these include: business strategy; employee characteristics; and firm characteristics. Key security challenges include: lack of financial resources; weak IT infrastructure; lack of cyber security knowledge; and lack of cyber security technical and human experience.

36 https://www.enterpriseresearch.ac.uk/publications/investigating-disparities-in-smes-digitalisation/
37 Understanding Artificial Intelligence Adoption and Use in Rural Small Medium Enterprises: An Opportunity to Level Up? - Enterprise Research Centre
38 https://www.enterpriseresearch.ac.uk/publications/what-do-we-know-about-cyber-security-in-small-firms/

The review observes that there is evidence that small firms in particular are being increasingly targeted by online threats as they are seen to be more vulnerable. This is due to their financial constraints, lower levels of attack prevention and often inadequate technical knowledge. Smaller firms are also more likely to have difficulties in complying with new regulations and deploying security measures. Small business owners and managers tend to have a weaker understanding of technologies and less expertise in risk assessments and the development of security policies. They are also less likely to have a member of staff whose role is to take care of IT, or to use an external cyber security consultant. In addition, the review notes that IT companies are the main source of information for smaller businesses on digital technologies. As the market is unregulated, this can be problematic, with smaller firms more vulnerable to poor advice and adopting inappropriate behaviours, including complacency about cyber threats. Smaller firms are also less likely to report cyber security incidents due to lack of time, resources and reputational damage.

We also continued our research in 2024 on the complexities involved in another key innovation area for small businesses – namely, net zero adoption. Small and medium-sized firms have been estimated to be responsible for an estimated 43 to 55 per cent of UK business greenhouse gas emissions, and as such they play an important role in moves towards net zero.[39] A paper presented at the 2024 ISBE Conference[40] summarised the insights from our ongoing research with the business support organisation WENTA, which is following small firms on their sustainability journey and involves in-depth interviews with firms on a net zero support programme.

This research has drawn attention to the competing goals that businesses have to navigate in the face of competing business, societal and environmental goals. These create tensions that can constrain the ability to make progress towards net zero goals. Tensions exist around: sustainability vs business goals; the investment required to adopt net zero practices vs the impact this will have; and wanting to engage with net zero vs wanting to avoid accusations of 'greenwashing'. This can lead to firms becoming stuck in a cycle of inaction, or minimal action, when it comes to sustainability initiatives, which it will be vital for policymakers to address going forward.

4.6 Summary

Innovation is strongly linked to business performance, but recent evidence shows some worrying trends in terms of declining innovation activity in UK, particularly in smaller firms. This is a key policy concern, particularly given the rapid pace of technological change and the increasingly competitive environment small businesses face. ERC research has shown that smaller firms face more innovation barriers and challenges. However, publicly funded support has been successful in improving innovation activity and firm performance. Looking ahead it is important that policy efforts are directed towards supporting innovation activity and digital technology adoption in small firms if the UK's growth ambitions are to be met. Innovation and digital technology support should also be designed so it can be attuned to local economic contexts, drawing on the evidence to address geographical inequalities.

39 British Business Bank (2021) Smaller businesses and the transition to net zero. Available at: https://www.british-business-bank.co.uk/sites/g/files/sovrnj166/files/2023-03/J0026_Net_Zero_Report_AW.pdf
40 ISBE 2024 – ISBE

5. Management and Leadership

From its earliest days, ERC research has explored the different ways in which management and leadership capabilities and practices are linked to small business performance. Most recently this research has had a specific focus on the management of workplace mental health and well-being, which has become a growing policy concern given the rising levels of mental ill-health amongst the UK population. We have strengthened our research insights in this area during 2024, gathering and reporting more longitudinal data.

5.1 The impacts of high-performance working

Previous ERC research has explored the links between so-called high-performance management practices (HPWPs) and firm growth. This work has shown, for example, that the use of HPWPs, such as the creation of project teams or problem-solving groups, and regular team meetings were strongly correlated with high growth episodes.[41] However, it is also the case that HPWPs are not as widely adopted within the small business population compared to larger firms for a range of reasons.[42]

One specific HPWP explored in a paper we published in 2024 is flexible working. The factors that lie behind the adoption of flexible working arrangements (FWAs) amongst small businesses, and their impact on business performance has been an underexplored area in research. Drawing on data from Scottish SMEs in the Longitudinal Small Business Survey (LSBS) between 2015 and 2022, this paper provides a comprehensive evidence-based analysis of the determinants of FWA adoption, as well as exploring its relationship with SME productivity and innovation. As well as investigating the general adoption of FWAs, the study also disaggregated FWAs into eight distinct types: flexitime, annualised hours contract, term-time working, job sharing, a nine-day fortnight, a four-a-half-day week, zero hours contracts and on-call working, as well as a category to capture 'other' flexible working hours arrangements.

The results show that FWA adoption is widespread, and that overall, three out of four Scottish SMEs with employees offered some form of flexible working arrangements, with variation by sector as might be expected. The type of contract most likely to be adopted was flexitime, or flexible working hours, offered on average in the period 2015-22 by more than two out of three firms with FWAs in place, and used in just over half of all Scottish SMEs with employees. There was also variation by business size in the adoption of FWAs, with smaller firms less likely to offer flexitime and instead relying more on zero-hours contracts.

Looking at the links with FWA adoption and performance, the findings indicate that the overall adoption of FWAs does not have a statistically significant impact on labour productivity. The exception here is nine-day fortnight working, which was positively associated with improved productivity, but was also the least used flexible work contract among those adopted by the Scottish SMEs surveyed. However, the analysis does show that SMEs offering FWAs, particularly flexitime, were more likely to report innovation activity. Further, different types of FWAs contribute to the intention to innovate, particularly flexitime and term-time working contracts. These findings highlight the association between flexible working practices and innovation behaviour in firms.

41 https://www.enterpriseresearch.ac.uk/publications/human-resource-practices-firm-growth-exploratory-analysis-matched-employer-skills-survey-ons-business-structure-database-statistical-report-produced-enterprise-resear/
42 https://www.enterpriseresearch.ac.uk/publications/high-performance-working-delivers-productivity-gains-isnt-common-sense-common-practice-amongst-uk-firms-sota-no-14/

Another area paper published in 2024 also pointed to similar findings, although this time with a broader focus on workplace inclusivity practices and innovation.[43] This analysis of employer survey data addressed three questions, namely: is workforce diversity positively related to innovation outcomes? How do HPWPs such as job variety, flexibility, and communication, contribute to innovation outcomes? and, how do workplace practices designed to support good worker mental health and well-being contribute to innovation? The results showed that building a more inclusive workplace was strongly associated with higher levels of innovation activity, in particular: greater workforce diversity in terms of gender, ethnicity and disability was positively associated with an increase in the propensity to undertake product and process innovation; providing flexible working was positively associated with a greater propensity to undertake product innovation; and taking measures to support employee mental health and well-being were strongly associated with both product and process innovation. The authors conclude that the findings of this analysis enrich the business case for building more inclusive workplaces, providing strong support for measures designed to promote employment diversity (by gender, ethnicity and disability), flexible working, and workplace mental health and well-being.

5.2 Workplace mental health

In 2024 we continued to work on our longitudinal research programme on workplace mental health and well-being. This work started back before the Covid-19 pandemic, with an initial survey exploring attitudes and practices around mental health and well-being in around 1,900 private sector businesses - all based in the Midlands region - carried out in early 2020.[44] The survey was subsequently repeated and data collected from firms in each of the years since (2021, 2022, 2023 and 2024), alongside new employer surveys carried out in Sweden and Ireland and qualitative work.[45]

Workplace mental health and well-being is a major challenge for UK employers. The latest official data indicates that 16.4 million working days are lost each year due to work-related mental health sickness absence - an average of 21.1 days lost per case, and that nearly half of all long-standing cases of work-related ill health in 2023/24 were due to mental health problems. The evidence also shows that mental health issues have grown in recent years. The rate of self-reported work-related stress, depression or anxiety was increasing in the years before the pandemic, but the current rate is now higher than the 2018/19 level.[46]

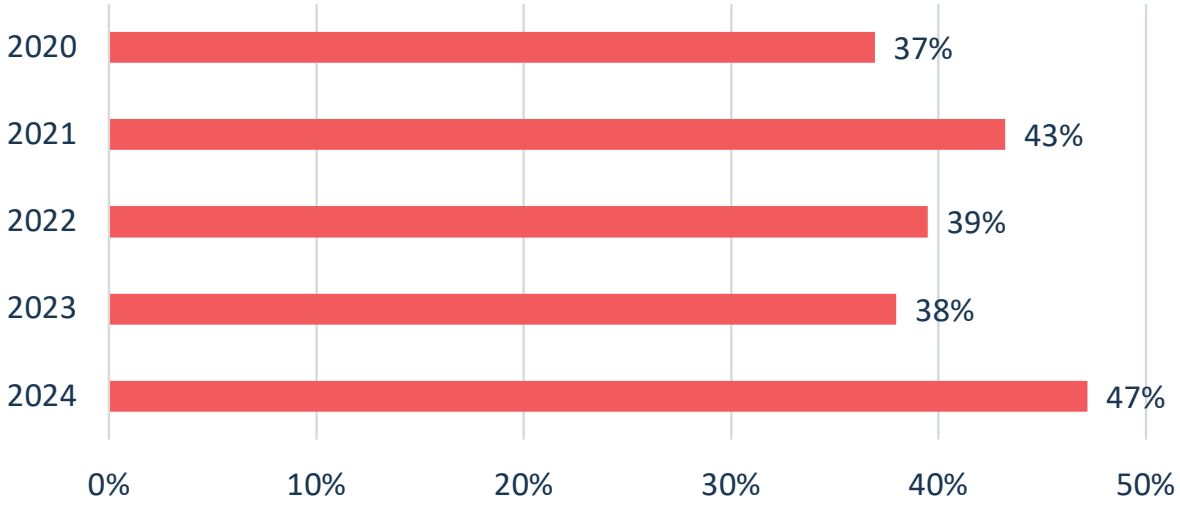
The firm-level direct costs of mental health issues have recently been estimated to sit at £51bn/year (Deloitte, 2024).[47] It is a concern with the business impacts of poor workplace mental health that has motivated our research in this area. Analysis of the survey data from our first survey in 2020 found that sickness absence related to mental health was associated with productivity which was lower by 18.3 per cent, and for those firms which reported an impact, it was associated with productivity which was lower by 24.5 per cent.

Our longitudinal survey data shows some revealing patterns into the ways in which firms experience and respond to the challenges of mental health issues. In early 2024, we carried out our fifth wave of data collection, and we published a report summarising the findings and exploring longer term trends in several key areas.[48]

43 https://www.enterpriseresearch.ac.uk/publications/do-more-inclusive-workplaces-lead-to-more-innovation-evidence-from-survey-data-for-firms-in-england/
44 https://www.enterpriseresearch.ac.uk/publications/employee-well-being-mental-health-and-productivity-in-midlands-firms-the-employer-perspective/
45 https://www.enterpriseresearch.ac.uk/esrc-mental-health-well-being-practices-outcomes-productivity-project/
46 https://www.hse.gov.uk/statistics/assets/docs/stress.pdf
47 https://www.deloitte.com/uk/en/about/press-room/poor-mental-health-costs-uk-employers-51-billion-a-year-for-employees.html
48 Workplace Mental Health in Midlands firms 2024 - Enterprise Research Centre

The findings show that mental health absence is slowly growing. In 2024, 27.5 per cent of firms reported that they had experienced some level of mental health-related absence in the previous 12 months. Although this has risen each year since 2021, it remains below the level of 30.5 per cent that was reported pre-pandemic. However, notably, long-term mental health related absence grew twice as much as general long-term sickness absence. The proportion of those firms with some level of mental health absence reporting that at least some of it was long-term in nature (i.e., four weeks or more), grew from 38 per cent in 2023 to 47.2 per cent in 2024, an increase of 9.2 per cent (Figure 11). General long-term sickness absence also grew in this period, but by only 4.3 per cent.

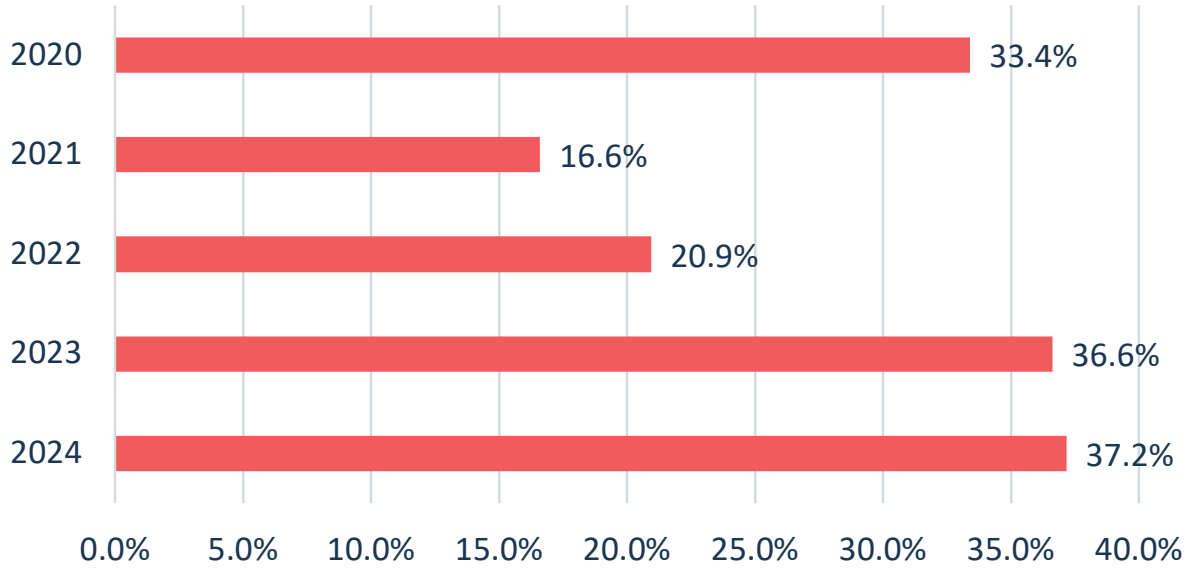
Figure 11: Proportion of firms reporting some level of long-term mental health absence in the previous 12 months, 2020 to 2024, all firms



Source: ERC Midlands Mental Health and Productivity Survey Series
Base: 556 firms in 2020, 338 in 2021, 480 in 2022, 471 in 2023, 482 in 2024

Presenteeism (where employees are working when unwell or routinely working beyond their contracted hours) also emerges as a major issue of concern in the findings. Employer reported presenteeism remains higher than it was pre-pandemic, being reported by 37.2 per cent of firms in 2024. This represents a small increase compared to 36.6 per cent in 2023. There was a substantial increase in presenteeism reported in 2023 – as in 2022 only 20.9 per cent of firms reported experiencing some level of presenteeism in their organisation (Figure 12). Nearly a third of firms experiencing presenteeism reported that it impacted on their operations, with the most frequently reported impact being ‘reduced performance’.

Figure 12: Proportion of firms reporting some level of presenteeism, 2020 to 2024, all firms



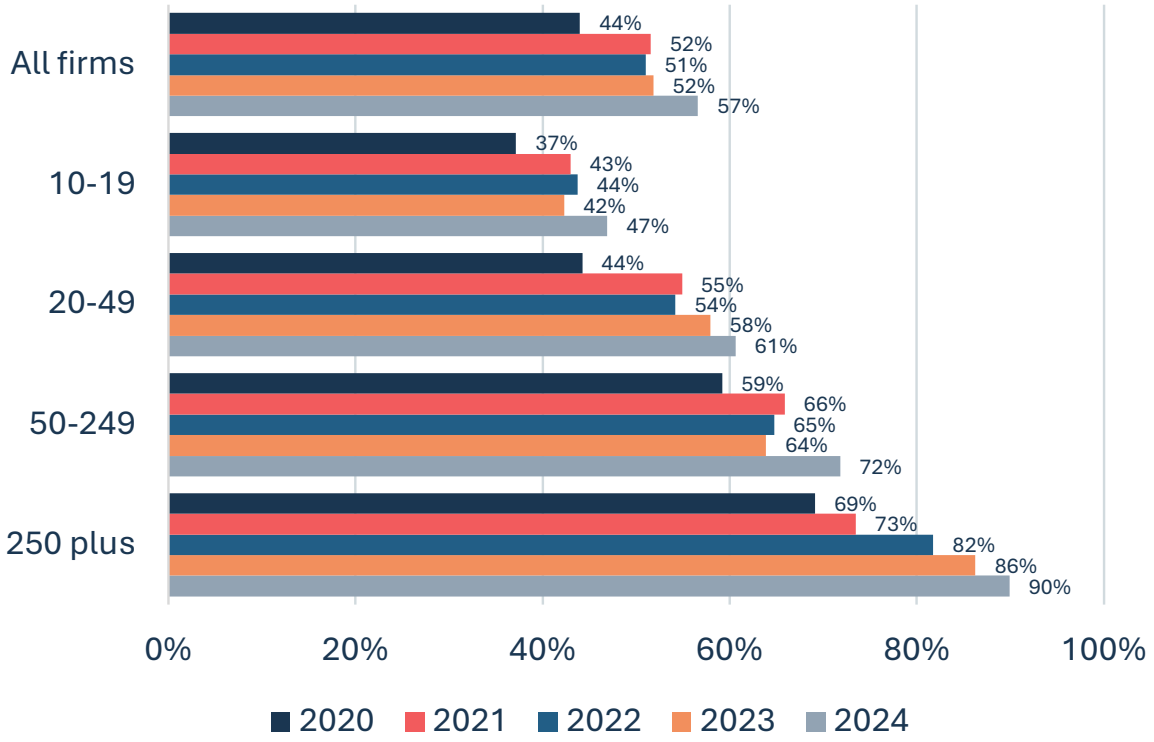
Source: ERC Midlands Mental Health and Productivity Survey Series
Base: 1899 firms in 2020, 1551 in 2021, 1904 in 2022, 1902 in 2023, 1901 in 2024

Turning to look at the use of mental health initiatives in the workplace, the survey findings show that engagement with mental health initiatives is most likely to be driven by individual managers with personal training in, or experience of, mental health issues, with respondents much less likely to point to evidence-driven motivations for the adoption of initiatives, such as an observed increase in mental health absence or increased signs of presenteeism in the workplace.

Another key finding from our survey is the presence of an 'attitude to action' gap. Most employers (77 %), disagree or strongly disagree with the statement 'mental health is a personal issue and not one that should be addressed in the workplace' indicating that they believe they have some responsibility to address mental health issues in the workplace. This is relatively stable compared to prior years. Although more firms have been adopting initiatives to address mental health in the workplace in the past few years (57% in 2024 compared to 52% in 2023, and 44% pre-pandemic), the gap between attitude and action remains, with 20 per cent more firms expressing the view that they should address mental health than are actually taking action.

There is also a clear pattern in terms of the proportion of firms that are adopting mental health initiatives by business size. Smaller firms are much less likely to have initiative in place compared to larger firms, as shown in Figure 13.

Figure 13: Proportion of firms adopting mental health initiatives, 2020 to 2024, by firm size



Source: ERC Midlands Mental Health and Productivity Survey Series
Base: 1899 firms in 2020, 1551 in 2021, 1904 in 2022, 1902 in 2023, 1901 in 2024

Despite these differences by firm size, the longitudinal evidence from our surveys points to a positive trend generally in terms of adoption of initiatives to support mental health in the workplace. However, the findings also show that employers are far more likely to adopt relatively low or no-cost initiatives. The bias is towards less formal practices, such as encouraging open conversations and awareness-raising, rather than costed activities such as training and development or provision of counselling services. In addition, only 22 per cent of firms said that they had a budget for mental health activities in 2024.

However, it is also the case that there has been a noticeable increase in the provision of training for line managers in managing mental health issues since the pandemic. This is a particularly important trend given that line managers play a crucial role in terms of managing mental health and well-being, as we noted in a previous ERC research paper, published in 2022.[49] The mental health and productivity research team have done some further analysis of the impact of line manager training that was published in 2024. This has shown that offering line manager training in mental health is associated with the adoption of other mental health and well-being practices and may increase awareness and readiness to tackle presenteeism (Dulal Arthur et al, 2024).[50 51] It is also significantly associated with some positive organisational outcomes, including improved staff recruitment and lower long-term sickness absence due to mental ill-health (Hassard et al, 2024).[52] Once again, however, there are clear differences in the provision of line management training by firm size, with larger firms more likely offer this type of training compared to smaller businesses.

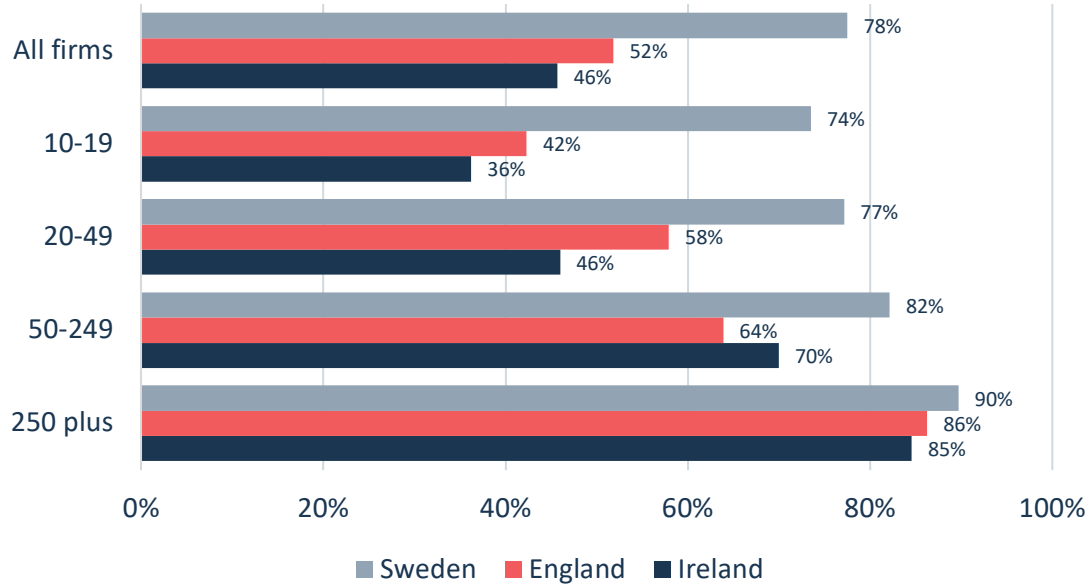
49 Line managers: The emotional labour of managing workplace mental health issues Enterprise Research Centre
50 https://academic.oup.com/occmed/article/74/6/416/7712333
51 https://bpspsychub.onlinelibrary.wiley.com/doi/10.1111/joop.12552
52 https://pubmed.ncbi.nlm.nih.gov/39018274/

The challenges faced by line managers have been further affected by the changes in working practices we have seen since the pandemic, and particularly the rise in remote and hybrid working. In 2024 our survey findings indicate that 30 per cent of Midlands firms had employees working remotely, although this varies considerably by business size, with smaller businesses less likely to have staff working remotely than their larger counterparts. Although 72 per cent of employers believed that employees working from home were happier, 53 per cent said that it made teamworking more difficult and 46 per cent said that employees working remotely can struggle because they lack interaction with others. Our qualitative research also shows that remote working can make it more difficult for line managers to identify employees experiencing mental health issues.

In 2024 we published new analysis that compares the findings from our Midlands surveys to two other national contexts: Ireland and Sweden, two countries with very different approaches to workplace mental health than found in the UK.[53] The findings were revealing. The evidence showed that businesses in Sweden were more likely than those in Ireland and England to report mental health-related sickness absence. The difference was particularly striking for long-term sickness absence (four weeks or more), which was reported by 88 per cent of Swedish employers compared to 38 per cent and 44 per cent of firms in England and Ireland respectively.

Despite being more likely to report mental health related absence, however, our research also found that businesses in Sweden were significantly less likely to say that such absence had impacted on the operation or performance of their business (43% of firms in Sweden compared to 58% in England and 46% in Ireland). This difference needs to be considered alongside the evidence on initiative adoption. Businesses in Sweden were much more likely to adopt mental health initiatives (78% of firms in Sweden had adopted initiatives, compared to 52% and 46% of businesses in England and Ireland respectively). Furthermore, the initiatives adopted by businesses in Sweden were also generally more strategic (e.g., having a mental health budget or a mental health lead at board level) and focused on holistic well-being (e.g., providing counselling support or gym membership). Our comparative research also shows that there are very striking differences between countries in terms of the proportion of smaller businesses adopting initiatives, as shown in Figure 14. Smaller employers in Sweden were much more likely to have initiatives in place than in England or Ireland.

Figure 14: Proportion of firms reporting mental health sickness absence in the preceding 12 months



Source: ERC Mental Health and Productivity Surveys – England, Ireland and Sweden
Sweden 1,000 firms, England 1,902 firms, Ireland 1,501 firms (2023 data)

53 More absence, but less impact on business performance. What can we learn from Swedish approaches to managing workplace mental health? - Enterprise Research Centre

Our findings indicate that the mental health agenda is more embedded in Sweden across firms of all sizes, and is typically prioritised at a more senior level within businesses. This is highly likely to be related to differences in legislation, policy context and culture. In both England and Ireland, we are more likely to discern a gap between attitude and action in workplace mental health than in Sweden, and there may be valuable lessons to learn from this different national context.

5.3 Summary

Management and leadership practices play a key role in business performance and growth. Although the management-performance link is complex, there is evidence that businesses that have experienced periods of high growth are more likely to use so-called high performance working practices. These practices tend to focus on maximising the capabilities and potential of employees, creating the conditions to nurture discretionary effort, which can lead to creativity and innovation.

In recent years, more attention has been paid to the importance of mental health and well-being in this context. The concept of 'psychological safety' has become used more widely – recently defined by the CIPD as referring to "how confident we feel to take appropriate risks at work because of our relationships with colleagues and managers."[54] Psychologically safe work environments and cultures create a climate of safety and belonging, and can empower people to achieve their full potential.

ERC research continued to shine a light on employer perspectives on workplace mental health and well-being in 2024. We have observed the growing uptake of employee mental health initiatives since the pandemic, which indicates an increased awareness of the importance of this agenda amongst businesses. However, our research also shows that smaller firms are lagging behind their larger counterparts in terms of the adoption of practices, and there is much room for improvement. It is important that the sizeable attitude to action gap we have observed in businesses in England is addressed given the continuing rise in mental health and well-being issues in the population and the potential negative impacts this is likely to have on productivity.

54 Trust and psychological safety: An evidence review | CIPD

6. Final Reflections

In this report, we have summarised the wide range of research and analysis that was conducted and/or published by the ERC in 2024. The year was another difficult one for small businesses, and 2025 looks set to bring a whole host of new risks and challenges. But, as always, there will be opportunities for small business leaders to strengthen their resilience, innovate and grow.

Our research and analysis indicate that there are a range of critical areas that are in need of attention if we are to create the conditions in which small businesses can thrive and meet both their own, and wider governmental, growth aspirations.

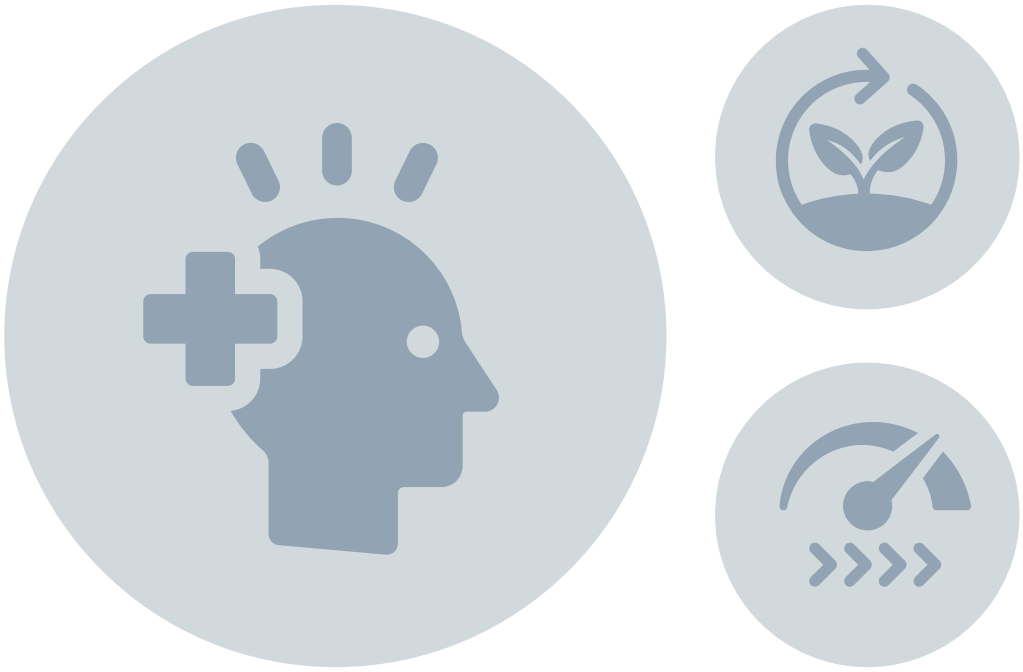
An overarching point is that policymakers need to start with understanding the realities of firm growth that we have uncovered through our research. The fact is that very few firms reach key growth milestones for a range of different reasons, and even when growth is achieved it is episodic and does not remain a constant state. Creating the conditions for more sustainable growth remains a key challenge for the UK, and one the Small Business Strategy to be published by the UK Government in the Spring of 2025 will need to address. Rather than focusing the small business growth strategy on 'high growth firms', we need to ensure that we create a range of inclusive support offers that can be accessed by businesses across the firm life cycle: from start-ups, through to accelerating the growth of businesses already showing signs of growth or ambitions to grow; and getting scaled businesses to move into new growth phases.

It also needs to be acknowledged that the UK's entrepreneurial ecosystem has been in decline for a number of years. We are now at the point where urgent action is needed in several key areas, particularly in entrepreneurial finance and business support. Running a small business is full of risks, and entrepreneurs routinely experience major challenges and threats to survival, which can happen at different points in the evolution of their businesses. As the pandemic showed us, sometimes these challenges can be unexpected and unanticipated and require considerable levels of agility and resilience to overcome. The same can be said for opportunities – to be a successful entrepreneur the ability to recognise and capitalise on opportunities is crucial, and these can come along at all stages of the firm lifecycle. Recognising these realities brings home the need for a strong and supportive ecosystem that can be accessed by all.

Opportunities for growth often involve entrepreneurs and leaders identifying problems and coming up with innovative solutions. In this context, the decline in innovation activity amongst businesses - and particularly smaller businesses - revealed by recent research evidence is very concerning. We need to address the causes that lie behind this decline and enable more small firms to engage in innovation, recognising this can take a variety of forms – be this product, process, service, business model, or any other type of innovation.

Innovation is key to firms remaining competitive and resilient, but it also requires entrepreneurs, leaders and managers to be proactive, ambitious and to take risks. This is of course more difficult in an environment of economic uncertainty. The government has an important role to play in providing a stable and supportive environment in which businesses feel able to invest in innovation. We know that the adoption of digital technologies in particular offers many possibilities for small businesses – indeed embracing these is often now a necessity if businesses are to survive in a competitive marketplace. But there many firms need support if they are to harness the benefits of technology effectively, and handle the associated risks that come with this. When it comes to the adoption of net zero practices too there is a similar picture. We can also see small businesses are clearly in need of more support to help them be confident about their actions and take the first vital steps on their path to sustainability. The magnitude of these issues means that it is time for a more concerted approach from policymakers.

Innovation also relies of course not only on the vision, ambition and skills of entrepreneurs and leaders, but also on the capabilities of the wider workforce. If we are to realise the growth potential of the country's small businesses, it is vital that more firms are investing in developing their employees. This is not only about training activities, but also about fostering good management practices and healthy organisational cultures. Our research on workplace mental health and well-being has drawn attention to the extent of the challenges here, showing that there are rising problems with long-term mental health absence and presenteeism, and a gap between attitude and action when it comes to addressing mental health and well-being in the workplace. Smaller firms are lagging behind their larger counterparts in terms of the provision of workplace mental health and well-being initiatives, pointing to a need for change in attitudes and practices here going forward. To sum up, there are several priority areas for action that emerge from our research, and we will continue to explore new dimensions of these in our programme of research in 2025. We will also continue to work closely with policymakers and stakeholders, sharing our insights to help create an environment that supports and nurtures the ambition, confidence, capabilities, resilience and innovation of the UK's diverse community of small businesses.



Annex

Annex: ERC website publications 2024

All publications are available at
https://www.enterpriseresearch.ac.uk/our-work/publications/

Research papers and policy briefings

115	**The impact of flexible work on SME Performance: An analysis of flexible working arrangements, innovation and productivity in Scotland** Sara Maioli, Pattanapong Tiwasing and Jane Atterton, November 2024
114	**The relationships between business support, managerial practices and firm performance over time** Stephen Knox, Samuel Mwaura and Victoria Oziri, October 2024
113	**Understanding Artificial Intelligence Adoption and Use in Rural Small Medium Enterprises: An Opportunity to Level Up?** Robert Bowen, Wyn Morris and David Dowell, October 2024
112	**Advice and SMEs: Who Takes it and What Happens Thereafter?** Ross Brown, Marc Cowling and Haoran Sun, October 2024
111	**Investigating Disparities in SMEs Digitalisation** Investigating Disparities in SMEs Digitalisation Samia Mahmood, Nadia Asghar and Kayvan Kousha, October 2024

State of the Art Reviews

63	**What do we know about cyber security in small firms?** JoanneTurner, September 2024
62	**What do we know about factors that affect business investment decisions?** Eugenie Golubova, August 2024
61	**What do we know about the factors that affect business export decisions?** Eugenie Golubova, June 2024

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Published: 19 September 2024

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Published: 18 July 2024

Workplace Mental Health in Midlands firms 2024
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Published: 23 May 2024

More absence, but less impact on business performance. What can we learn from Swedish approaches to managing workplace mental health?
Published: 25 April 2024

Innovation state of the Nation Survey 2023
Published: 24 April 2024

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Published: 9 April 2024

R&D-intensive businesses in Wales: Innovation and contribution to turnover and employment
Published: 21 March 2024

Business investment – drivers, barriers and economic impacts. A rapid literature review
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The State of Small Business Britain 2023 A manifesto for small business growth and productivity
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Do more inclusive workplaces lead to more innovation? Evidence from survey data for firms in England
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Jun Du 24/09/2024

Equity finance access and use in early-stage UK ventures
Robyn Owen 10/09/2024

Let's talk about another M in the business population – Micros
Mark Hart 01/07/2024

What can we learn from Swedish approaches to workplace mental health?
Maria Wishart 30/04/2024

Insight Papers

54	**The State of Small Business Britain Conference Report 2024** Vicki Belt, December 2024
53	**R&D and innovation pathways to business productivity and growth: What does the evidence suggest?** Stephen Roper, May 2024
52	**What kind of Business Advice improves Small Business Productivity?** Andrew Henley, March 2024
51	**Evaluating the local business growth effects of the UK City of Culture 2013 and 2017** Stephen Roper, February 2024
50	**Productivity Puzzles, Long tails and Productivity Heroes: developing a new focus for small business policy in the UK** Mark Hart and Karen Bonner, February 2024

Exploring Enterprise Podcasts

Episode 21:Delivering effective business support

01/08/2024

Professor Mark Hart, Deputy Director at the ERC is joined by David Taylor, Founder and Managing Director of the business DNA six as well as being as a business adviser, coach and author, alongside Jodi Fair, who is Programme Manager at Solent Business and Skills Solutions, a free business support service. The discussion today is both important, practical and relevant, looking at how we should be delivering effective business support to the nation's small businesses?

Episode 20: Small businesses and exporting

12/06/2024

Professor Stephen Roper, Director of the ERC is joined by William Bain, Head of Trade Policy at the British Chambers of Commerce; Jun Du, Director of Centre for Business Prosperity (CBP) and Professor of Economics at Aston Business School; and Eugenie Golubova, Research Fellow and my colleague at the ERC reflecting on the range of issues associated with small businesses and exporting.

Episode 19: Understanding micro-businesses

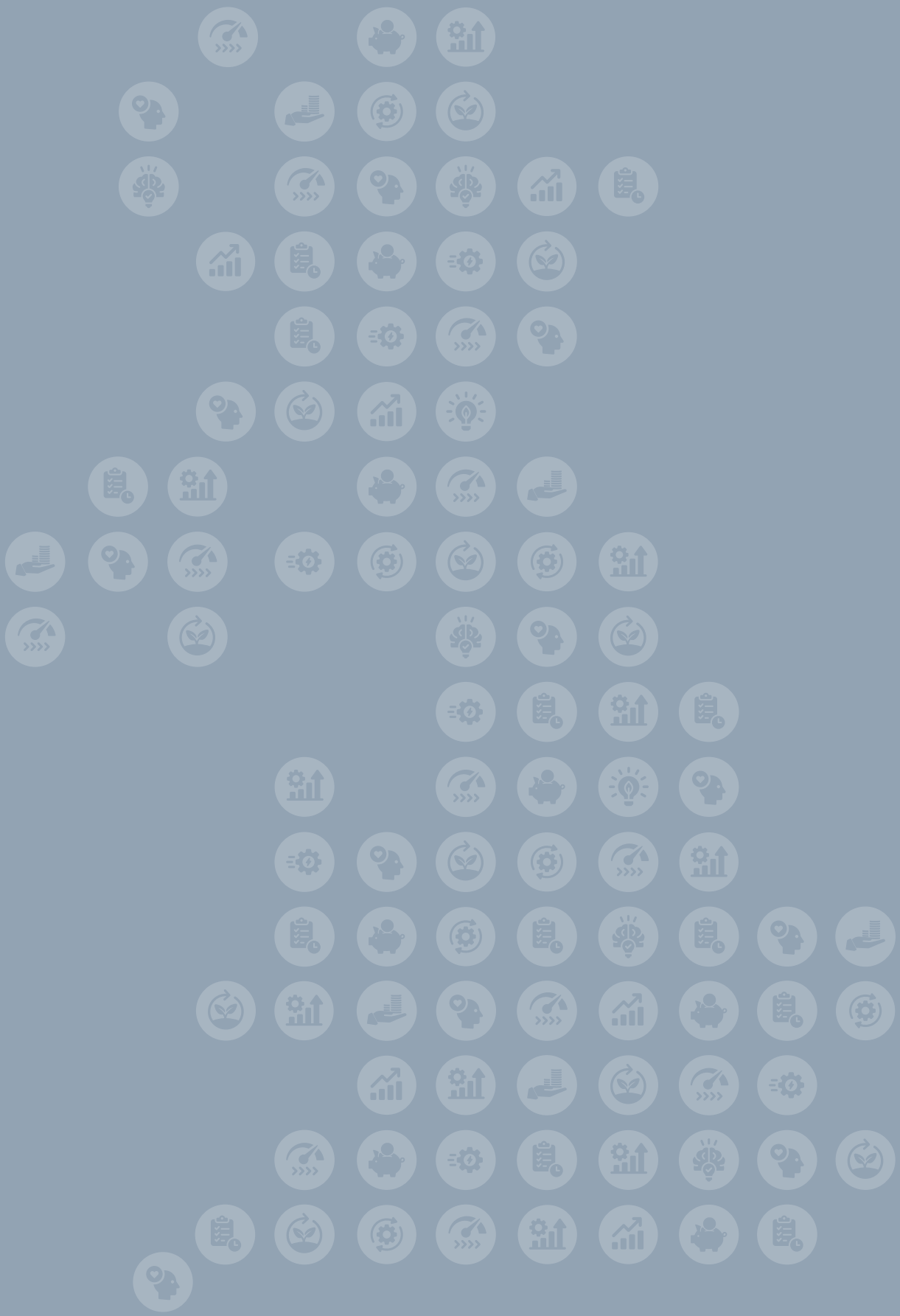
29/04/2024

Professor Mark Hart, Deputy Director of the ERC is joined by Emily Whitehead, business coach, consultant, and Founder of Simply Great Britain, and Professor Andrew Henley, Professor of Entrepreneurship and Economics at Cardiff Business School reflecting on the world of micro-businesses or micro-enterprises, an under-researched and perhaps misunderstood part of the business population, in spite of their prevalence in the economy.

Episode 18: Supporting better management in small businesses

23/01/2024

For the 18th episode of Exploring Enterprise, the podcast series from the Enterprise Research Centre, Professor Mark Hart, Deputy Director of the ERC is joined by Manny Athwal who is an entrepreneur and the founder and current CEO of the School of Coding, and Ian McLaughlan, who is Director of Business Growth West Midlands, a new business support service to reflect on the important theme of how to support better management in small businesses.



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