Full scale

How to ensure more British firms grow to their potential

John Asthana Gibson
Aveek Bhattacharya

SMF Social Market Foundation

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Kindly supported by

FIRST PUBLISHED BY

The Social Market Foundation, September 2023
Third Floor, 5-6 St Matthew Street, London, SW1P 2JT
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ACKNOWLEDGEMENTS

The SMF is grateful to OakNorth for sponsoring the research. The Social Market Foundation retains full editorial independence with respect to its research.

We are also grateful to all the participants in the roundtable for sharing their wisdom, experience and insight, to Sherry Coutu and Mark Evans for their feedback on an earlier draft of this report, and to Shreya Nanda for assisting with the background research for this report.

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FOREWORD FROM THE SPONSOR

By Rishi Khosla, CEO & Co-Founder, OakNorth

When the UK is described as 'a nation of shopkeepers', it is generally seen as a positive reflection of the hard-working, small-scale businesses that serve their local community, but we can and must be more ambitious than this.

Why do so many businesses find it so hard to go from small-scale to mid-scale? Why should these businesses be limited to only serving their local community, instead of being able to think on a national or even international scale? We know first-hand the disproportionally positive impact that successful growing businesses have due to the c.£10bn we've lent to date: it's directly contributed to the creation of more than 40,000 new jobs and 29,000 new homes across the UK. We also know from talking to our clients that so many innovative businesses across the UK have the ambition to scale up, but still face multiple barriers holding back their growth.

In the post-Brexit, post-pandemic quest for UK economic recovery, identifying the barriers holding British businesses back has become an increasingly prominent topic for debate. As a neobank devoted to serving and empowering the "Missing Middle", we feel we need to champion this and get some answers, which is why we're pleased to commission a report from the Social Market Foundation on this.

Of course, at OakNorth we know access to capital is a challenge for many scaling businesses – it's why we launched in 2015. However, this report demonstrates that access to capital is not the only challenge, in fact it's not even the primary one for these businesses. The SMF's roundtable and research has revealed the range of challenges and thanks to the contributions of some excellent people has set out some compelling fresh thinking about what government and other stakeholders need to do to make a meaningful difference. It will take political will, clear strategy and a concerted, well-resourced effort, but if the Government of the day takes the challenge on, we will all gain.

So please read this report, share it with others and spread the word about its recommendations for letting British businesses go Full Scale.

EXECUTIVE SUMMARY

The UK is an attractive place to start a business. More people in Britain, absolutely and proportionately, are involved in start-up companies than in any other big European economy. However, the UK is considerably less successful than international peers at scaling them up to become highly productive and sizeable firms. This limits the country's economic success: having a vibrant start-up culture is of little benefit to the wider economy if start-ups fail to grow, or if successful ones choose to relocate elsewhere to expand. Enabling these firms to become established offers the promise of tens of thousands of new jobs, a more productive and innovative economy, and rising living standards.

It should be no surprise then, that the issue has received considerable policy attention, though views differ as to the most significant barriers to growth. Generally, politicians have tended to spend most time thinking about capital markets, assuming access to finance is the key constraint on scaling up firms.

This paper offers evidence to suggest that this focus has been too narrow, and that capital – while important – cannot solve the problem alone. Instead, there are a range of factors preventing scale-up companies from achieving their full potential – from poorly focused and uncoordinated government support, poor access to foreign markets, restrictions on attracting global talent, failures in developing the UK's own skills bases, planning restrictions on development, cumbersome procurement procedures and a reticence in encouraging and mentoring more people to start and scale successful businesses. This is not to say that accessing capital is not a major issue for scale-up firms, indeed it is likely to grow in significance with recent interest rate rises, but as with the other issues, a meaningful response needs to be targeted and coordinated as part of a range of complementary measures.

Of all these issues, access to skilled human capital ranks highest as a concern among SME directors. This was the consistent message we received from business and economic experts we spoke to and is reinforced by our analysis of the Longitudinal Small Business Survey, which shows that staff recruitment and skills is the single most frequently reported obstacle impeding the UK's fastest growing small and medium sized companies.

We recommend a range of policy measures to help Britain's scale-ups succeed. The government should:

- **Establish a cross-governmental Scale-ups Unit**, with the mission of creating an £50bn in public market cap value from UK growth startups over the next 5 years by 2028. The unit should be led by the Department for Business and Trade and should facilitate promising businesses to access support and remove frictions, coordinate and evaluate government policies and schemes and direct public money to the most effective interventions – across immigration, health, treasury funding, industry, workplace and pensions, research funding, tax incentives, regulation.

- **Identify key sectors to prioritise for the UK**, such as green/climate science, fintech, life sciences, data science/AI, therapeutic care services, hospitality/tourism, creative/performing arts. For each of these sectors:
  - Identify a geographic hub for the sector, playing to current strengths while also ensuring that hubs are spread across the country.
  - Attract the best global talent in each of these sectors to these hubs, and facilitate visas for that talent.
  - Invest in the UK's skill base in each hub around the specific sector – scaling up the local universities in each hub, including for adult education, tripling research spending – to create talent density around each sector in each hub.
  - Target financial interventions to support firms in promising clusters – potentially using EIS/SEIS/R&D credit budgets and focusing on equity investment through the British Business Bank.
  - Reform planning to boost business and homes in each hub.
- Create a more supportive environment and business culture for scale-ups, with a particular focus on reducing bureaucracy and **making public and private sector procurement more favourable**.
- Increase funding for schemes like Be the Business to enhance their capacity to **provide training and mentoring for leaders** of growing companies.
- **Remove barriers to university spin outs** – by standardising agreements with universities – e.g. 5% university ownership for professor-led spin-outs and 0% for students – IP kept by start-up companies – and rely on philanthropy.
- **Help promote increased ambition in the UK,** by showcasing success stories, and celebrating and mentoring entrepreneurship at schools, colleges and universities.

CHAPTER ONE – INTRODUCTION

Concerns around company growth sit in the context of a stagnating UK economy

Broadly speaking, the UK has a thriving business environment. Its legal system and financial institutions, language, culture, and geography are all seen as conducive to enterprise. The country ranks 8th in the World Bank's Ease of Doing Business Index, the second highest European country after Denmark.[1]

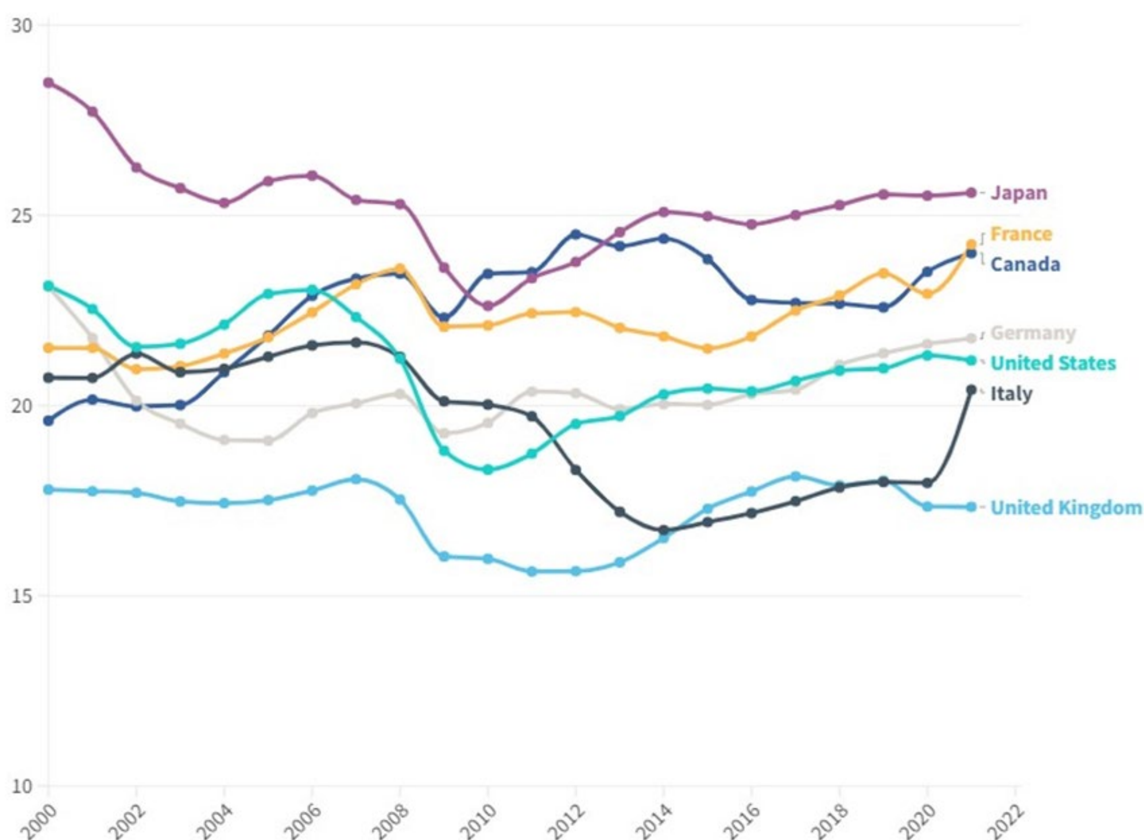
However, the UK's recent poor economic performance has given rise to concerns that it may be losing its competitive edge. Though Brexit, the pandemic, and the spike in energy prices sparked by Russia's invasion of Ukraine have all contributed to the stagnant growth of the past few years, its troubles pre-date these recent crises, and stem from longer-standing structural weaknesses.

Poor health, for example, is one of the most common causes of Britons' economic inactivity, evident both before and since the pandemic.[2] This has contributed to Britain being the only G7 country where economic inactivity has continued to rise since the ending of COVID-era restrictions.[3]

Weak levels of investment are also partly to blame. Capital investment in UK businesses and public infrastructure has consistently lagged other peer economies (see Figure 1), tumbling further after the 2008 financial crisis and yet to return to pre-crisis levels.[4] British workers now have less software and machinery to help them do their jobs than their foreign counterparts.

The outcome of these structural challenges is stagnating productivity, which in turn has terrible consequences for the UK's business environment. Innovative, scaling companies are loathe to invest and operate in a stagnating economy. There are also wider impacts beyond business competitiveness. Workers in France, Germany and the United States now nearly produce in four days what British workers make in five, and citizens in those countries are much better off for it.[5]

Figure 1: Gross Fixed Capital Formation as % GDP, G7 countries 2000-2022



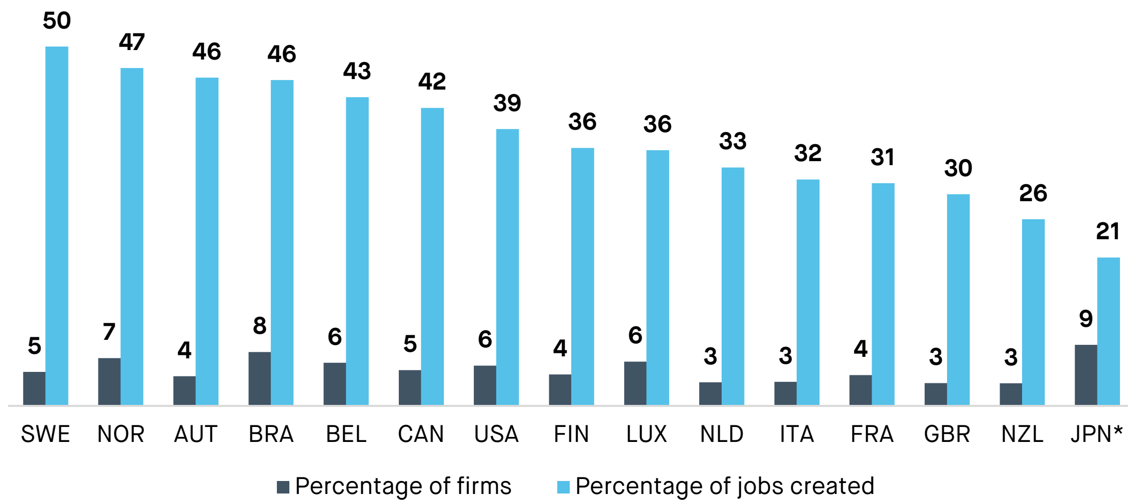
Source: World Bank Data: Gross Fixed Capital Formation (% of GDP)- OECD Members

Britain's poor economic performance diminishes the growth prospects of UK scale-ups

Despite the economic woes the UK has suffered in recent years, the country has maintained its reputation as a hub for ambitious start-up companies. In key high-innovation start-up sectors such as fintech, artificial intelligence and life sciences, the UK performs well relative to peer countries, particularly with regard to attracting investment.[678] Britain has become a hub for tech firms, of which the fast-growing raised £24 billion of investment in 2022, more than France (£11.8 billion) and Germany (£9.1 billion) combined.[9] Across numerous industries, the UK, and London in particular, has become a major global hub for start-ups. London was ranked second (tied with New York) in Startup Genome's list of the top 30 global start-up ecosystems. [10]

However, whilst effective at getting people to start companies, the UK is considerably less successful at scaling them up to become highly productive and sizeable firms, with the UK's start-up firms failing to realise their potential compared to international peers. Analysis from the OECD found that although growing start-ups[i] represent a similar proportion of all firms, they account for a lower share of employment growth compared with peer nations (see Figure 2).[11]

Figure 2: Growing start-ups' percentage of all start-ups and contribution to net start-up job variation, 2001-2010



Source: Criscuolo, C., P. Gal and C. Menon (2014), "The Dynamics of Employment Growth: New Evidence from 18 Countries", OECD Science, Technology and Industry Policy Papers, No. 14, OECD Publishing, Paris, https://doi.org/10.1787/5jz417hj6hg6-en.

Beyond the country's macroeconomic difficulties, there are some more specific problems that afflict the UK's scale-ups and may make it harder for them to grow. While funding may be plentiful for early-stage start-ups, it is harder for growing firms to access capital at later stages. The Economist recently reported that in 2020, only 22 life-sciences companies in Britain raised £30 million or more in funding rounds, compared to nearly 400 that did so in America.[12] Industry leaders and policymakers alike fear that high-growth British start-ups will up sticks and exit the UK in search of higher growth prospects elsewhere, taking their innovations and skilled jobs with them.

[i] *Growing start-ups are firms with less than 10 employees at the age 0 to 2 years with growth of over 10 employees over a three-year period*

High-growth SMEs are of critical importance to the UK economy

Having a vibrant start-up culture is of little benefit to the wider economy if start-ups fail to grow, or if successful ones choose to relocate elsewhere to expand. This is because 'scale-up' businesses[ii] can do a great amount of good for society; providing hundreds of thousands of people with jobs that support communities, driving up productivity and innovation and generating economic growth. According to the Scaleup Institute's 2022 Annual Review, the 34,000 scale-ups in the UK were on average 42% more productive than other firms in the same sector.[13] Being some of the most ambitious, innovative, and productive firms, scale-ups make an outsized contribution to the economy. They represent 50% of the total SME (small and medium-sized enterprises) turnover output despite making up less than 0.6% of the SME population, employ over 3 million people, and generate £1.2 trillion for the UK economy. A companion SMF paper to be published later this year will dig deeper into the characteristics of these firms, and their contribution to the British economy. Our intention for this additional paper is to demonstrate which sectors provide greatest impact to our economy, or show comparative advantage that can be deepened, in order to guide the sector/regional hubs that we advocate for more focused and coordinated government support.

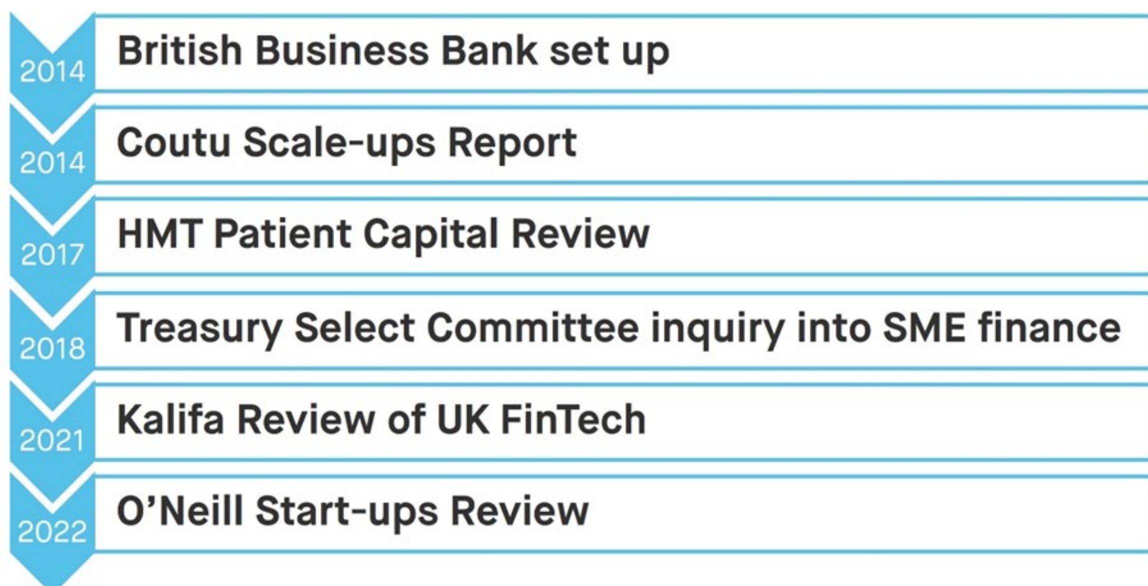
Britain's current period of economic stagnation undoubtedly makes it harder to get its SMEs growing as they should. But scale-ups' failure to reach their full potential in turn contributes to the economy's stagnation, creating a vicious cycle. Breaking that cycle is of critical importance to the health of the UK economy.

A succession of reviews and policy changes have sought to address this problem of weak company growth

Given the importance of these scale-up firms, there has been a great deal of policy attention towards the barriers to expansion they face. Politicians and policymakers of all stripes agree that better supporting the success of such innovative British companies is a "good thing", although actually addressing these issues has proved more challenging. Over the past decade, there have been a series of reviews and policy changes attempting to make it easier for SMEs to grow (see Figure 3).

[ii] Scale-ups are technically defined as firms that have had an average annualised return of at least 20% in the past three years and had at least 10 employees at the start of the three-year period. But for the purposes of this paper, the concept of a 'scale-up' can be more broadly interpreted as highly productive small and medium-sized firms with considerable growth potential.

Figure 3: Key reviews and policy changes over the past decade



Source: SMF analysis

One of the most significant of these was the creation of the British Business Bank (BBB). Established in 2014 with a mandate to try and improve the supply of finance to SMEs in the wake of the financial crisis, and to boost competition in the business banking market, it has since turned towards equity investment, recognising the significance of the equity finance gap. Over time, it has shifted away from seed funding for start-ups to growth funding to help scale the most promising businesses. As of 2022, its portfolio was split evenly between the two, and this has so far achieved strong returns for the taxpayer. The creation of the BBB does seem to have fostered growth in the wider venture capital scene. UK venture capital investment has grown substantially in recent years, and 14% of equity deals between 2019 and 2021 were backed by the BBB. Perhaps most striking: as of June 2022, the majority of the UK's 'unicorns'[iii] – 19 out of 33 – have received some form of equity support from the British Business Bank.[14]

2014 also saw the publication of The Scale Up Report by Sherry Coutu, commissioned by the coalition government.[15] It developed a plan of action across six main areas: i) improving data and reporting, ii) accessing talent; iii) developing leadership; iv) access to customers in both domestic and foreign markets; v) financial support; and vi) infrastructure. These recommendations were broadly ranked in order of priority – critically, the report identified companies' issues with hiring employees with the right skills as the most pressing barrier scale ups face. The paper helped instigate a flurry of policy work in the following years, with numerous reviews and inquiries seeking to understand the issues bedevilling SME firms in greater depth, and to provide policy solutions to tackle such issues.

[iii] A 'unicorn' is a privately held company valued at over US $1 billion.

Policy attention and media coverage has focused on access to finance as a barrier on company growth

Despite the Coutu report coming to the clear conclusion that a lack of access to human capital, rather than finance, is the principal barrier preventing British companies from scaling, subsequent policy attention and media coverage has tended to focus on the financial system.

In 2017, the Treasury launched a review into the effective use of patient (long-term) capital to support innovative firms to access the finance that they need to scale up, involving a panel of entrepreneurs, academics and investment professionals, culminating in a number of recommendations to tackle the problems scale-ups face accessing patient capital for growth. One proposal was the creation of a patient capital investment vehicle, enabling the aggregation and deployment of patient capital for investment in UK businesses. The new entity would seek to invest around £1 billion annually, primarily in UK venture capital funds and other investors in high growth businesses, supported by some government investment to signal strategic intent and stability.[16]

In the following year, the Treasury Select Committee conducted an inquiry into SME finance, publishing a report detailing the key issues around SMEs accessing the capital they need to grow. The committee addressed commonly discussed problems with the supply of finance to SMEs, but also less discussed demand side issues too. The inquiry looked into the lack of awareness of different forms of growth capital, and problems relating to the perception of external finance to many SME businesses, highlighting that the expectation of being turned down leads many businesses to avoid applying in the first place.[17] The Committee has recently closed a call for evidence on a subsequent inquiry into SME finance – the outcomes of which will be published in due course.

In 2020, Ron Kalifa OBE launched a review with the objective of identifying priority areas to support the UK’s fintech (financial technology) sector, an industry which has flourished in Britain in recent years. The review set out a series of proposals, including amendments to UK listing rules to make the UK a more attractive environment for listing companies by allowing dual class shares and relaxing pre-emption rights, and improvements to tech visas to attract global talent and boost the fintech workforce.[18]

Then, in 2022, the Labour Party made a significant contribution to the debate in the form of the *Start-up, Scale-up* review, making use of a panel of experts and entrepreneurs led by the economist Lord Jim O'Neill. The review was carried out with the ambition of developing policies that can help Labour achieve its ambition of making Britain "the best place to start and grow a business". Notably, of the five key recommendations of the review, three were financial in focus. The first one listed is "Unlocking institutional investment and patient capital", creating forums to build engagement between institutional investors and venture capitalists and developing ways for ordinary savers to invest in high-growth firms. The review also suggested reform of the BBB and greater incentives for investment in entrepreneurship. The other main recommendations were to allow founders of university spin-outs to take a greater stake in their businesses and to reform public procurement practices to be more favourable to start-ups. Nevertheless, Lord O'Neill's review followed the pattern since the Coutu report of prioritising capital above other barriers to growth.

That fixation has been replicated recently in statements by government and opposition. The Chancellor's Mansion House speech in July 2023 focused on boosting the supply of investment capital available to support the growth of high potential businesses.[19] The shadow chancellor has also signalled the Labour Party's intent to push pension funds to pump cash into UK start-ups and high-growth firms.[20]

For all this policy attention, scale-ups say that things are getting more, not less challenging – in a 2022 survey, 58% of leaders said that it is harder to grow their business than in the past, up from 41% the previous year.[21] There remains, it is clear, much work to do.

This report contributes to the debate around scale-up growth

This report re-evaluates the conventional wisdom that finance is the sole barrier limiting SME company growth and highlights the significance of policy attention towards other critical aspects, with a particular emphasis on human capital. It is important to emphasise that finance remains a crucial factor in SME growth; however, policymakers should broaden their scope to address other equally important dimensions. The report underscores that a narrow focus on finance alone may not yield optimal results unless complemented by effective actions in other areas.

To achieve this, the SMF has conducted a review of key literature in this policy area and conducted new analysis of the Longitudinal Small Business Survey. This report has also been guided by a roundtable discussion with key stakeholders, including experienced business figures, policy experts, investors and entrepreneurs. Their views will be reported throughout the report.

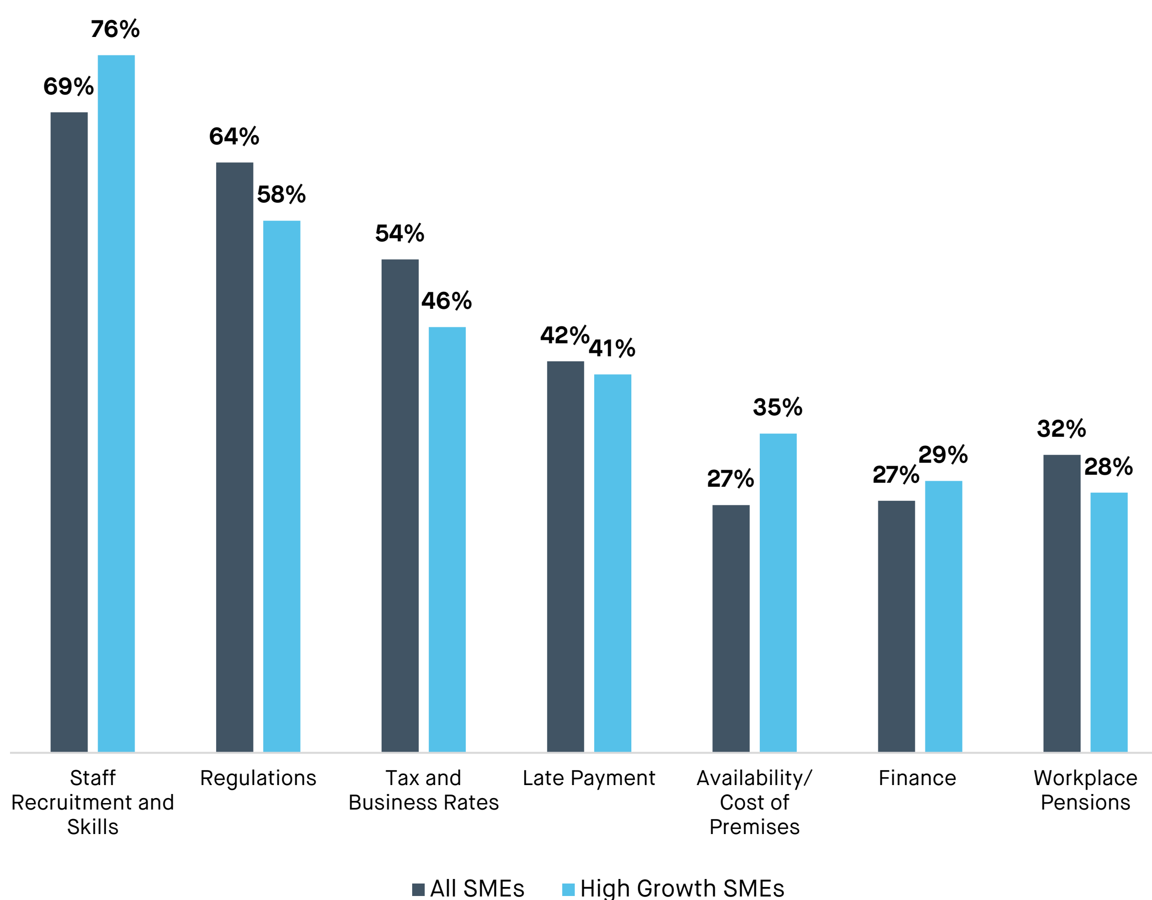
This report will assess a number of barriers in turn, weighing up evidence as to the extent to which each is a significant barrier preventing growth. Finally, the report will provide policy recommendations illustrating what solutions can be implemented to help Britain's scale-ups succeed. These recommendations contain fresh, detailed measures for providing holistic, coordinated, targeted support to British scale-ups that address the full range of barriers to growth that this report identifies.

CHAPTER TWO – BARRIERS TO GROWTH FACED BY SCALE-UPS

In recent months and years, policymakers have been focused on scale-ups' issues with accessing capital above all else. Access to finance is no doubt important, but the extent to which it is the major constraint on scale-ups' growth is likely to be overstated. Instead, the findings from our engagement with stakeholders, review of key literature and analysis of the Longitudinal Small Business Survey all point to the problem of obtaining the right skills as the principal barrier preventing expansion of high growth companies. In other words, hiring workers who have the right talents and skills is the biggest issue facing scale-up companies today.

Figure 4 presents the findings of our analysis of the Longitudinal Small Business Survey. From the survey, we constructed a dataset containing small and medium sized firms which answered a question on the main barriers to their success. These firms were categorised by their growth rates over any 3-year period between 2016 and 2021 – those that had grown 50% in three years were classified as 'high growth'. When individual firms responded to question over multiple years, the most recent response was taken.

Figure 4: Percentage of firms reporting issues as barrier to their business success by firm type



Source: Longitudinal Small Business Survey, SMF Analysis.

The findings from this analysis clearly indicate that accessing the right talent and skills from workers is the most pressing barrier impeding the growth of scale-ups. Of the remaining barriers, some are likely to represent greater obstacles to scale-ups than others, and our findings indicate that accessing skills, suitable commercial space in the right locations, and capital in particular are the most problematic constraints for companies. That said, there are a panoply of other barriers on company growth that each deserve attention.

Six barriers to growth appear consistently in the literature and discourse around company growth. The paper will examine these barriers in the following order:

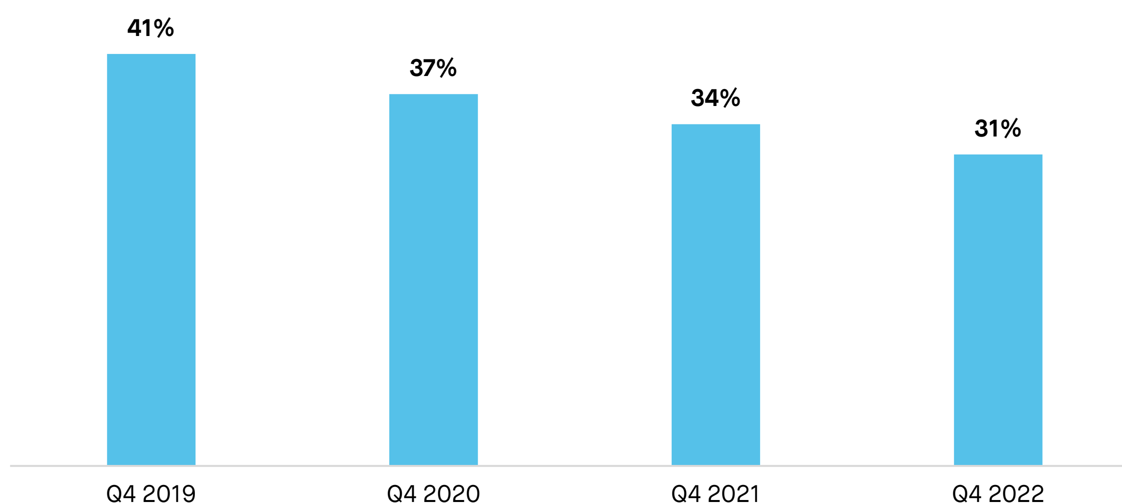
- Access to finance
- Access to talent and skills
- Infrastructure and planning
- Access to markets
- Government procurement & regulation
- Culture, leadership and management

Access to finance

The first barrier to consider – the one that politicians continue to prioritise – is scale-up firms' lack of access to finance. Our analysis has already suggested – as the Coutu report did back in 2014 – that finance is not the strongest constraint on high growth firms. Similarly, the Institute's 2022 annual review reports that access to the right bank/equity finance is only the third highest rated barrier to growth identified by scale-ups. 43% put finance in their top three ranked issues, behind both access to UK and international markets (73%) and access to talent (62%).

Moreover, most SMEs do not report having difficulties accessing external finance, and those that do are a falling minority, declining from 41% In 2019 to 31% in 2022 according to BVA BDRC's SME Finance Monitor (see figure 5).[22] This fall would seem to offer encouragement that policies seeking to address barriers to accessing capital have been working.

Figure 5: SMEs reporting that they think it would be difficult to access external finance



Source: BVA BDRC SME Finance Monitor

The idea that access to finance is overrated – while still being significant – was the consensus in our roundtable too. One roundtable participant with experience of capital markets and the scale-up ecosystem expressed the view that “if a scale-up has a good idea, they won’t struggle to access finance”. Another said that “if we focus on finance, we will completely cock up”.

That also fits with the findings of academic researchers. Ross Brown and Neil Lee have shown that although high growth SMEs are more likely to apply for external finance than other SMEs, their success rate is no lower. Across a series of papers, they conclude that the issue is not one of ‘discouraged borrowers’, ‘strapped for cash’ and unable to borrow, but rather of ‘reluctant borrowers’, that resist external funding because of a lack of trust in lenders or an unwillingness to compromise their autonomy.[23] Though of course there are many worthy scaling companies that seek to borrow and are unable to do so - which is precisely why businesses like OakNorth, the sponsor of this paper, exist - Brown and Lee observe that “it is important to state that not all firms deserve the finance they apply for”.

The general consensus throughout the roundtable discussion was that access to capital receives disproportionate policy attention, perhaps because it is seen as an ‘easy lever to pull’. Another explanation is that finance can easily be captured with widely understood metrics, whereas other less tangible issues such as talent, leadership and culture cannot be so easily measured.

That said, nobody thinks that British capital markets serve scale-up firms perfectly and even if less of a priority than other concerns, there is certainly more for policy to do. Financing is an integral part to the growth of any business. According to the Institute, 82% of scale-ups utilise external finance.[24] Finance enables scale-ups to invest in the expansion of their production processes or in innovations that increase productivity and business competitiveness, empowering firms to stay ahead of rivals. Evidence suggests a firm with limited or no access to external capital may be constrained in its ability to pursue an optimal investment policy which, in turn, may inhibit company growth.[25] Further research has shown that increased access to finance for business investment results in higher employment growth, especially among micro, small, and medium enterprises.[26]

Scale-up firms need capital to finance business improvements and ultimately their expansion. Finance will enable them to hire more workers, invest in machinery or software, and advertise and grow into new markets. Without it, British scale-ups will struggle to become much more than small firms with good ideas.

Weak institutional investment limits scale-ups' access to growth capital

The pools of long-term capital in the UK are the biggest and deepest in Europe, with pension funds making up a significant share of this 'patient capital', alongside insurance assets, retail investments, endowments and foundations. Yet despite having deep pockets flush with cash, only a tiny proportion of institutional investors' pools of long-term capital is invested in capital hungry British firms seeking growth. A report by New Financial, a think-tank specialising in the operation of capital markets, found that just 12% of the £5.6 trillion across pensions, insurance, direct retail investment and endowments is invested in the British stock market, less than 4% is invested outside the FTSE 100 and less than 1% of the £4.6 trillion in pensions and insurance assets is invested in unlisted UK equities.[27] There is money to invest, but not enough makes its way into scale-up companies. Illustrating the scale of the issue, the report found that a one percentage point increase in these investors' allocation to unlisted equities would unlock £55 billion for UK companies that could assist their expansion.

It is commonly argued that the UK's institutional investors have been excessively cautious and should invest more in growing companies that tend to deliver greater returns.[28][29] Returns from UK pension funds have been among the poorest in the industrialised world.[30] On the other hand, such companies, due the higher levels of risk inherent in their business models, are less suitable targets for certain forms of patient capital.

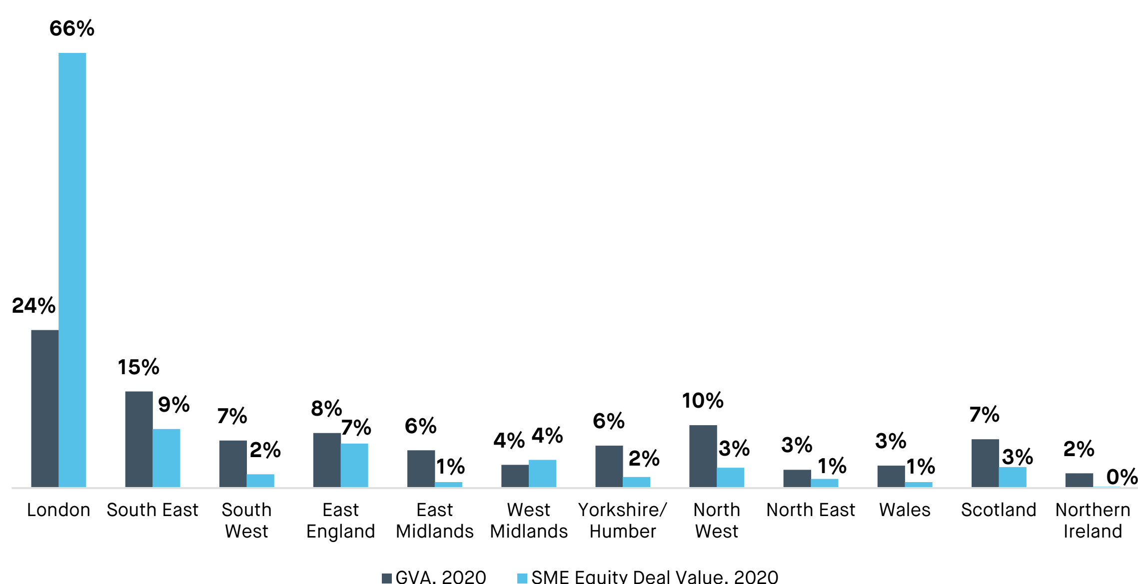
There are substantial regional inequalities in access to equity funding

Equity finance, the issue of new shares in exchange for a cash investment, is also a key source of capital for scaling high growth companies, providing growth capital to 6 in 10 scale-ups.[31] Venture capitalists are key providers of capital to these firms because whilst many start-ups and scale-ups hold great potential to make significant profits they initially lack cash to invest, or assets against which to secure loans. Venture capitalists often provide not just finance for expansion, but guidance to aid the expansion, based on experience helping other firms to grow.

Yet there are substantial inequalities in access to private equity investment, particularly venture capital investment. Most equity finance deals taking place in the Greater South East, which draws around three-quarters of all equity finance (see figure 6). The probability of a firm getting equity funding is up to 50% lower in nearly all regions outside London.[32]

Scale-ups in London benefit from having a venture capital industry on their doorstep, where fund managers can know their clients and invest confidently in these growing businesses. Scale-ups in other regions of the UK are not so fortunate: scaling firms outside of the capital struggle to access equity financing. This has the effect of producing virtuous circles in London, and vicious ones outside. Without local knowledge, venture capitalists are reluctant to invest in local areas, which in turn means firms are less likely to seek out equity finance. [33]

Figure 6: Share of UK economic output and SME equity finance by region



Source: British Business Bank, Regions and Nations Tracker: Small Business Finance Markets 2021; ONS, Regional gross value added (balanced) per head and income components

Obtaining capital from the stock market is less attractive in the UK than elsewhere

Firms can also raise capital from investors who, if a firm does an IPO, will get the liquidity needed to exit and hopefully realise a healthy return on their investment. These public capital markets are therefore key sources of growth finance for expanding firms, particularly those that are at the later stages of the scaling process and need significant levels of capital to become larger established firms.

The London Stock Exchange has historically been a major centre for both global and domestic firms to raise capital through initial public offerings (IPOs). However, there are concerns that London is becoming a less attractive place to publicly list companies. IPO activity on the London stock markets fell 90% by funds raised and 62% by number of listings in 2022 when compared to the record highs of 2021.[34] The number of listed companies in the UK has fallen by about 40% from a peak in 2008, and announcements of companies plans to list elsewhere in the world, such as that from Arm (a Cambridge-based semiconductor firm known as the 'jewel in the crown' of the British tech sector), and more recently the polling and data analytics firm YouGov, have exacerbated fears of London's declining attractiveness for raising capital through the stock market. [35] [36] [37]

There are several reasons why firms may be incentivised to list in other global centres rather than in London. Access to deeper pools of capital elsewhere, particularly in the US, explains part of this problem. Listing rules is likely to be another. A Treasury review found that London's stock market listing rules are too complex and carry burdensome requirements that drive businesses to list on competitor markets. UK stock markets don't allow dual-class shares, where some shares (usually held by founders) have more voting power than others. Refusing to allow dual class shares makes UK listing less attractive to ambitious business owners seeking to fully scale their companies and has been identified as a potential reason companies are turning to other markets.[38] This lack of access to capital from the stock market is particularly bad news for scale-ups at the later stages of expansion. Participants in the SMF-run roundtable conversation broadly agreed that whilst growth capital is seemingly plentiful for early-stage start-ups, obtaining such finance gets increasingly difficult as firms get bigger due to the lack of growth investors in the UK. That is a view that seems to have been gathering momentum in business circles for a while – featuring, for example, in an opinion piece by OakNorth chief executive Rishi Khosla last year.[39]

These problems have problematic implications for scaling firms' access to capital and represent a considerable barrier to the growth of scale-up companies. Yet they are just part of the wider national issue of weak business investment limiting company growth – inflicting long-term damage on the economy as a result. The Resolution Foundation found that if UK business investment had matched the average of France, Germany and the US since 2008, GDP would be nearly 4% higher than it is today.[40] To make the UK a more conducive environment to grow scale-ups into established firms, the constraints on access to capital must be alleviated.

Access to talent and skills

Access to finance is clearly important, but policy attention has been 'over-focused' on this one issue alone. As we have seen since the landmark Coutu review in 2014, a considerable number of policy reviews relating to SME growth have focused on finance as a barrier curtailing growth, yet too few have followed up her original emphasis on *human* capital and access to skills.

Instead, there is a much greater range of barriers preventing growth, and access to skills is among the most salient. One roundtable participant argued that “it’s pretty much all about human capital”. As one of the key inputs into firms’ production processes, the productivity of human capital (determined by the talents and skills of workers) matters a great deal for the competitiveness of companies as a whole.

There is evidence that a lack of access to talented workers with the right skills is preventing UK scale-ups from growing and reaching their full potential. Often these highly productive businesses work in niche sectors and require niche skillsets to match. But according to the Institute, 80% of scale-ups are currently finding it challenging to recruit the right people either for a specific role or who have specific skills. [41] The Department for Education’s 2019 Employer Skills Survey highlighted that nearly a quarter of all vacancies were skills shortage vacancies – i.e. those that cannot be filled because the employer cannot find the skills they need.[42]

The findings from our analysis of the Longitudinal Small Business Survey reinforces the case that access to human capital is the most pressing barrier on growth. The analysis found that between 2016 and 2021, ‘staff recruitment and skills’ was the most frequently reported obstacle impeding the success of ‘high growth’ companies, cited as a problem by three-quarters of such firms.[iv] Notably, high growth companies were even more likely to identify skills as a challenge than other firms. Given that access to skills is a key consideration for firms in choosing where to locate, these figures should give real cause for concern.

Two areas of policy have significant relevance to this issue. The first is the UK’s education and training system, which influences the skills produced domestically. The second is the immigration system, which impacts the level of skills we can obtain externally. This section will assess the two in turn.

The UK’s education system often fails to give young people the key skills desired by scale-ups

By and large, the UK’s education system performs fairly well. Students in the United Kingdom scored higher than the OECD average in reading, mathematics and science in the 2018 PISA rankings. [43] The country is also home to one of the world’s most prestigious university sectors, attracting hundreds of thousands of international students each year.

[iv] Firms with more than 10 employees at the start of a three year period who experienced turnover growth of more than 50% during that period.

The British education system has its limitations, though. A 2019 survey of UK adults with tertiary education found that they were split down the middle on whether they had developed the skills they need: 51% said that their studies did not prepare them for their careers.[44] In some of the most job-relevant skill domains of business, technology and data science, the UK does comparatively poorly. In Coursera's international ranking of human capital, which is focused on those key skill areas, the UK ranked a dismal 64th in 2023.[45] Tech and digital skills is a particular area of concern. According to the Institute, these are the areas where scale-ups face the greatest recruitment challenges, with 55% experiencing workforce skills gaps.[46] The UK faces a severe 'digital skills deficit', with an estimated 10 million adults lacking essential digital skills.[47] Yet despite growing demand for these skills from a booming tech industry, the education system has been slow to rectify the gap in tech and digital skills. The number of students taking technical IT or computing qualifications has actually decreased by a third since 2015, falling from 33,000 students to just 22,000 students.[48]

For all the challenges facing the university sector, things are even tougher for those seeking other options that do not involve studying to degree level. The SMF has for some time argued that Further Education colleges are under-resourced and under-appreciated.[49] Unlike other countries, where higher technical qualifications are a common and valued pathway for school leavers to attain employer-focused technical skills, the UK (and England in particular) provides fewer such opportunities. Only 1.5 adults per thousand complete higher technical qualifications each year, lower than in most other advanced economies.[50] This is partly a cultural issue, in terms of the prestige and value placed on different education routes. However, it is also largely to do with funding: per student funding and the number of available places remains constrained for vocational options than for higher education.[51]

Adult education in general has also been impacted by funding cuts since 2010, with total spending on adult education and apprenticeships falling by 38% between 2010–11 and 2020–21.[52] That compares unfavourably with countries such as Sweden, which recently launched a scheme offering workers study grants worth 80% of their salary to fund professional development or retraining.[53] Here, by contrast, there is a growing sense that adult skills provision is inadequate to the task of ensuring workers maintain their skills and adapt to new technologies and shifting demands. According to one survey, 74% of British adults say colleges and university focus too much on young students and do too little to support working adults.[54] Despite dramatic improvements in the range and quality of flexible modular learning and training options, these are not yet as easily accessible as they ought to be. The Lifelong Learning Bill, currently passing through parliament, is attempting to encourage support greater modularisation within higher education, breaking funding down into credits. Yet it remains to be seen how far that shifts practice within providers.[55]

Overall, then, the UK falls considerably short of providing the technical and transferable skills that scale-ups need to run growing enterprises. Roundtable participants broadly agreed that basic digital competencies are some of the fundamental skill requirements all scale-ups look for in workers. Moreover, there is too little provision and support for people seeking to upskill or reskill in later life. This is not just the fault of policymakers – to some extent, it reflects the failure of businesses to invest in their workers and to create a culture of continuing skill acquisition. Below, we consider how British firms can better engage with the education system, but policymakers must do their part. The UK's failure to develop the skills required by highly productive scaling businesses represents a damaging long-term constraint on the growth prospects of these companies. Fixing that issue is a long-term project. In the short term, however, domestic skills shortages can be somewhat alleviated by sourcing talent from elsewhere in the world.

There are barriers to drawing in talent from overseas

The UK has long been an attractive place for migrant workers. Good employment opportunities, a widely spoken language, and a deep-rooted commitment to the rule of law and fairness has meant the UK has attracted millions of immigrants over recent decades, bringing great talent and skills with them. This has been good for firms, who have benefited from deeper pools of labour – ensuring not just that they can hire more people, but also have a greater chance of finding the right fit with the appropriate skills for their position. Access to foreign talent has been especially beneficial to scale-ups, who require the very best talent to outcompete rivals. Such talent can't always be sourced domestically. Migrants also bring entrepreneurial strengths to the UK, playing a disproportionate role creating the most profitable and innovative companies. The Entrepreneurs Network has revealed that while just 14.5 per cent of UK residents are foreign-born, 39 per cent of the UK's fastest-growing businesses in 2019 had at least one foreign-born co-founder.[56]

However, Brexit, ending the free movement of people between Britain and Europe, has disrupted the supply of talent to British shores across many sectors and industries. The UK Government has since implemented a points-based immigration system, with the aim of labour immigration policy enabling a high-wage, high-skill, high productivity economy.[57] [58] Under this system, applicants are required to have a job offer from employers above a certain pay threshold and pay high visa fees.

As a consequence, highly skilled workers from the European Union now face considerable barriers to entering the UK. For those employers that had relied on freedom of movement, the shift to sponsorship came with material additional cost, administrative complexity, and legal responsibilities and obligations. The same is true for potential employees. In-demand software engineers from the EU will likely find it easier to work with similarly ambitious tech firms within the bloc, rather than spending considerable time and money to come to the UK.

In theory, this system is supposed to enable more non-EU skilled workers to access the UK. However, there are other non-legal barriers that prevent non-EU skilled workers from moving to the UK; most obvious is the greater distances between the UK and non-EU sources of talent.

Some might point out that most of the recent rise in net migration has been driven by migrants from non-EU countries. However, when these figures are examined in greater deal, we can see that most of these migrants are not high-skilled workers entering the labour market. The vast majority have entered to study or for humanitarian purposes (particularly Ukrainians and Hong Kong British national overseas status holders). Only 24% of the increase in long-term non-EU immigration from 2019 to the year ending December 2022 resulted from those arriving for work purposes.[59] Of the increases in skilled workers coming to the UK, much of the growth has been driven by those coming for health and care work.[60] This is welcome, as the NHS is in need of skilled foreign workers to function effectively, but there will be a limited impact on firms' problem of obtaining human capital if talented arrivals are coming to mostly work in hospitals and care homes rather than growth hungry start-ups and scale-ups.

By cutting off highly skilled workers from our immediate neighbouring countries (where non-legal barriers are lowest), it leaves a skills gap that is difficult to fill. The UK's ranking in the Global Talent Competitiveness Index has fallen from 7th to 11th since 2019, reflecting the country's declining attractiveness as a destination for high skilled workers.[61]

These increased barriers on hiring foreign talent are bad news for UK scale-ups. It limits their ability to find the specific skills they need to run and grow productive businesses. As there will be increased competition for a smaller pool of talent, scale-ups will likely have to fork out more to attract such talent, increasing business costs and decreasing competitiveness. The UK Government has attempted to remedy some of the problems high growth firms face accessing talent by introducing the 'Scale-up worker visa' in August 2022. Being a relatively recent intervention, the impact of the scheme is yet to emerge. Whilst it is an encouraging step, it is unlikely to be adequate to mitigate the wider impacts on talent acquisition of the UK's withdrawal from the EU.

Some argue that the loss of foreign talent will be compensated by domestic skills due to improvements in the UK education system. However, such improvements typically take many years to have an effect on the UK's skills base. In the short-term, the greater constraints on hiring foreign talent will inevitably limit scaling firms' access to talent. Given the importance of talent to the success of scale-ups, they will likely see their potential for growth diminish, and many will be incentivised to either shut up shop or relocate elsewhere.

Infrastructure and planning

The UK's planning system impedes the growth of scale-ups

There are other considerable non-financial barriers to company growth, and the UK's restrictive planning regime is undoubtedly one of them. Across the country strict planning regulations limit companies' abilities to build physical infrastructure and therefore the ability to expand, and the discretionary (case-by-case) nature of the planning process discourages development.[62] This is an issue impacting scaling firms across the country, but it particularly hits certain sectors which typically require more commercial space than firms in other industries (e.g. life sciences, advanced manufacturing, etc). Moreover, because the planning system limits the number of homes cities can build, it is harder for innovative people to benefit from being around one another, and for innovative firms to attract staff without being able to offer affordable housing near their labs and offices.[63]

These constraints are also most pronounced in some of the most productive parts of the country, namely cities in the Greater Southeast such as London, Oxford and Cambridge (dubbed the 'Golden Triangle' by virtue of the pioneering industries located there). Many start-ups and scale-ups seek to operate their businesses in these places because of the access to key ingredients for growth for these firms: deep pools of highly skilled workers and cutting-edge science and technology research.

However, the onerous rules around building physical infrastructure, whether it be office, logistical or laboratory space, mean that the supply of commercial space can't keep up with growing demand, pushing up costs of scale-ups' expansion and damaging their competitiveness. This mismatch is illustrated by the fact that 'Golden Triangle' cities have the highest costs of commercial space in the UK.[64]

It has been reported that the US city of Boston added six million square foot of laboratory space in 2021, whilst Oxford and Cambridge combined develop about 300,000 in an average year.[65] Due to these rigid planning rules curtailing development, British scale-ups will be encouraged to up sticks and move to locations more permitting of firm expansion, taking their well paid jobs, innovative ideas and tax pounds with them.

Yet the impacts of the planning system don't just hurt scale-up firms in the most successful parts of the country. In fact, it is a nationwide issue, and these costs paralyse UK scale-ups and harm the UK economy as a whole. Our analysis of the Longitudinal Small Business Survey found that firms with the highest levels of growth more frequently cited issues around accessing/ affording suitable premises than they did reporting finance as a key barrier on success, giving weight to the argument that the discretionary planning system constrains the growth of Britain's most pioneering companies.

Further barriers impeding the growth of scale-ups

The obstacles to growth presented so far – access to finance, a restrictive planning system and, above all, access to talent – are on balance the greatest constraints on scale-up expansion. Yet there remain a number of often less discussed problems that stand in the way of company growth.

Access to markets

Scale-ups' abilities to access and grow into foreign markets is one of these issues. The ease with which firms can sell their goods or services abroad matters for their ability to increase sales and generate higher revenues for expansion. However, since Britain left the EU, British firms' access to one of the world's largest consumer markets has been severely curtailed. This has particularly impacted goods firms selling physical goods, which have been more impeded by cross-border disruptions. These barriers have also hurt smaller exporting businesses more than larger ones, as larger ones are more likely to have the resources to navigate increased bureaucracy. A survey conducted by the Federation of Small Businesses found that a quarter of small exporting businesses exited the European market three months after the UK withdrew from the European Union.[66] Notably, the Institute's 2022 review found that access to domestic and international markets was seen by scale-ups as the single biggest barrier to their growth.[67] One of our expert participants observed that the relative ranking of these barriers shift from year to year, and that the relative pessimism around access to markets may partly reflect the passing psychological impact of Brexit. That said, they added anecdotally that British firms tend to be more wearied than continental counterparts, with Brexit exacerbating the difficulties of the pandemic and high inflation.

The UK Government has tried to compensate for the loss of one key export market by opening up trade to others, striking free trade deals with Australia in 2021, New Zealand in 2022, and in July 2023, it signed an agreement to join the CPTPP, a trading block of 11 Asia-Pacific countries.[68] However, it is unlikely that greater access to these new markets will compensate for the loss of the European market for exporting scale-ups. This is because there are other non-tariff barriers to trade that limit the extent scale-ups can export into these new markets, most obviously the costs imposed by the greater distances involved, but also cultural and social barriers too. As such, the reduced levels of access to the European market UK scale-ups now face is a limit on their growth potential.

Government procurement

Government procurement policy also has significant implications for the growth of young scaling companies. Public sector organisations such as schools, hospitals and police forces spend large sums buying services from the private sector. In 2019/20, £295.5 billion was spent on procurement – about a third of all public sector spending.[69]

Yet not all firms have equal access to lucrative government contracts. This is in some senses 'natural' – smaller firms do not build aircraft carriers or railway tunnels alone. Nevertheless, many small businesses are put off by the layers of excessive bureaucracy created in the name of value for money for the taxpayer and to reduce risk. Public sector organisations will often specify criteria for suppliers, such as proof of the ability to deliver contracts of similar size or records of past performance, which inherently favour larger incumbent firms over smaller entrants. These barriers to start-ups and scale-ups accessing public sector contracts has meant that a select few established firms, such as Capita, G4S, and Serco, increasingly receive the lion's share of the state's private sector spending, reflecting a long-running shift towards 'strategic suppliers'.[70] The Penrose Report on competition, published in 2021, found that between 2013 and 2017, the 25 largest firms increased their share of contract value from 13% to 18%.[71] Research by the British Chambers of Commerce found that just one in every five pounds spent on UK public sector procurement went to SMEs.[72] Moreover, not all of these will be scale-ups – the fact we do not have better data on scale-ups specifically reflects the limitations around data that Sherry Coutu's review raised as an issue almost a decade ago.[73]

It is not just the Government's procurement policy that limits SME growth, but that of larger UK corporations too. One participant of the roundtable conversation argued that compared to other countries, bigger British firms do too little to support smaller start-ups. Like government, they too often have inflexible procurement processes, and managers are often discouraged from innovating their procurement processes. Instead, they're incentivised to maintain the status quo and "buy IBM", as one roundtable participant put it. By contrast, participants in the roundtable suggested that American firms, particularly tech firms, have more of a culture of supporting start-ups and incumbents collaborating with newer firms, in part because American executives anecdotally are more likely to be 'angel' investors in such companies. Procurement is thus part of a broader ecosystem of relationships between large incumbents and start-up firms, which builds up to the depth of investment exemplified by Microsoft's £10 billion stake in OpenAI, which our participants argued would be inconceivable in the UK today.

The difficulties small and mid-sized firms face in accessing government contracts, investment and support from larger corporations is an unfortunate constraint on growth. These firms miss out on revenue streams that could make the difference between sustainable expansion and failure. It is also bad for government and large business, who lose out from an inefficient procurement system, but also society, which misses out on the innovations nimble scale-ups can deliver for public services and key consumer markets.

Government regulation

How the Government regulates firms also has ramifications for scale-up companies, particularly those in certain cutting-edge industries. Our analysis of BEIS' Longitudinal Small Business Survey found that 'Regulation' was one of the most frequently reported obstacles restricting the success of 'high growth' enterprises, with 58% of such companies reporting it as a barrier. Often regulation serves a purpose to protect consumers, the environment, or certain groups of people, so an unqualified and wide-ranging approach to cutting red tape is likely to be neither socially nor economically desirable, and regulatory divergence from EU standards could entail negative economic consequences.[74]

However, there are instances where bureaucratic regulatory processes might stifle innovation and limit high-growth companies from expanding.[75] In certain innovative sectors, such as the life sciences sector, approval processes can be slow and bureaucratic compared to other countries, causing delays that hike up business costs and weaken the ability of firms to grow (although the Government has moved to tackle these problems with clinical trials).[76] [77]

Yet this issue is not only creating hurdles for firms in the life sciences sector. There are fears that other high-growth industries might suffer from burdensome approval processes that could stifle innovation. Artificial intelligence is one such sector, and one where the right regulatory approach is still being forged. Whilst regulating powerful new technologies must ensure the protection of the public, there is a risk of creating burdens that limit the potential of AI firms to sustainably scale in the UK.[78]

Culture, leadership and management

The final aspect related to growth this paper considers is the UK's culture of entrepreneurship, and the leadership and management skills of senior business leaders.

There is a debate over whether certain aspects of the UK's culture discourage company growth. During the roundtable discussion, participants were in sharp disagreement over the significance of culture. One participant strongly argued that it did, and that Britain lacks a culture of entrepreneurism where success is encouraged. "No profession in the UK is actually celebrated", that "if you make money because other people are working, then you're seen as exploitative", and that until this changes the UK will be "an environment that is anti any professional scaling". Another participant highlighted the role of the media in propagating negative sentiment around being successful in business.

It is also worth noting that media plays a role in shaping perceptions around success in the UK. Negative sentiment towards success and wealth accumulation in some sections of the media can contribute to the perception that financial success is undesirable or exploitative. Addressing this aspect of media influence is another challenge that should be considered when discussing the cultural factors affecting entrepreneurship and growth in the UK. However, the bigger problem, as we see it, is a lack of grand ambition and a failure to recognise areas where British people and organisations are, or could be, genuinely world-class. This self-assessment and national ambition play pivotal roles in shaping the cultural landscape and attitudes toward entrepreneurship and growth.

Some participants remained sceptical, pointing out that even if culture is a factor that limited the capacity of UK scale-ups to grow, there are no obvious levers to pull to change it. They argued that those concerned with growth should instead be focused on barriers such as access to capital and skills, and other more tangible issues where problems can be reliably measured, and practical solutions enacted to solve them.

In our view, culture is important in business success and growth, and research exists that supports this claim.[79] Yet there is a limit to what government can do to actively shape it – suggestions mooted at the roundtable such as recognising business success through the honours system were quickly dismissed as ineffective and tokenistic. Policy should focus on more tangible issues such as skills, finance and infrastructure. In any case, it seems likely that culture is an area in which success breeds success – as more scale-ups grow and more examples of success become apparent, it is likely that cultural norms will shift accordingly.

The leadership and management skills possessed by business leaders is also of significant importance to this debate, and the ability of small and medium-sized companies to build the right team with the right skills at the top of their businesses has long been recognised as a critical component of sustainable company growth. According to the Institute's Annual Review 2022, developing the skills of the current senior team is seen by leaders as the most promising route to higher growth.[80] Roundtable participants also expressed the view that companies can be limited by the capabilities and skills of their bosses, and that key leadership and management qualities grow in importance as companies expand. The scale of this issue was highlighted in a 2015 government report finding that that nearly three-quarters of SMEs in England report deficiencies in L&M Skills.[81] Improving the leadership and management skills of business leaders could therefore lift a key constraint on business growth in the UK, and unlike national culture, there are material things policymakers could do in this domain.

CHAPTER THREE – POLICY RECOMMENDATIONS

To encourage the expansion of high growth enterprises, the Government should take a comprehensive look at the multiple obstacles that curtail their successes. This section lays out some the reforms needed to help Britain's lucrative scale-ups develop and deliver an even greater contribution for the UK economy.

The Government should establish a cross-governmental Scale-ups Unit, led by the Department of Business & Trade, with the mission of creating an additional £50 billion of value over five years from scale-ups

Before diving into those specific barriers, we have an overarching recommendation to ensure that the agenda receives appropriate government focus and that there is some accountability for addressing the problem. As we have seen, the country's challenges around scale-ups have been an issue for the better part of a decade. Yet the Government has failed to make a sustained effort to address the issue. There have been several periodic reviews and policy announcements, but sustaining momentum has been difficult. It has largely been left to private organisations – notably the Scaleup Institute – to keep the agenda moving.

One reason is a lack of ownership and accountability. As one of our participants put it, "government coherence matters critically: is there any cross-departmental coordination from Immigration to Education to Health to Treasury to Industry to Work and Pensions to Home Office to Research Funding?" To bring some oversight and responsibility, a cross-departmental Scale-ups Unit, led by the Department of Business and Trade, should be set up. This group would track the state of the ecosystem, map out the various government and private forms of support for scale-ups, identify barriers to their growth and seek to find and resolve barriers and blockages elsewhere in the policy or economic system.

As the Coutu Review pointed out, data and measurement represent a major challenge to the agenda. The Scale-ups Unit should oversee tracking the number and growth of UK scale-ups over time. It should also evaluate the various business support schemes that exist, with an eye to identifying what works and should be scaled, and what does not and should be scrapped.

Our roundtable raised the example of the Enterprise Investment Scheme and Seed Enterprise Investment Schemes, which offer tax incentives for investing in early-stage high risk companies. In 2021/22, 6,750 firms raised over £2.5 billion through these schemes, yet it is unclear whether this has produced any outstanding successes.[82] A 2007 evaluation found that firms benefitting from EIS enjoyed some growth in sales and employment, but not in profitability.[83] There should be more such analyses, following firms over a longer period to identify how many achieve substantial success, and what can be learned from the programs.

There should also be efforts to estimate the return on investment, recognising the opportunity cost of such funding, and seeking to consolidate resources into the most effective. One question that arose in the roundtable was whether funding would be better directed at specific sectors of existing skill and comparative advantage – the Scale-ups Unit should delve deeper into such questions, encouraging some degree of testing, learning and iteration in funding. To really change things, it is critical that the Scale-ups Unit is not just a passive observer and analyst, but is an active agent, facilitating businesses to get the support they need and to address the challenges they may face within government. It cannot create scale ups, but it can develop the conditions they need to thrive, taking away frictions and ensuring government policy is effective.

There is a precedent that proves such units can be impactful - the Bank of England's New Bank Start-up Unit for example, has successfully removed barriers to entry for new banks, and granted dozens of new licences in recent years in an effort to diversify the sector. However, once again, the focus has been on start-ups. New banks would also benefit from a new bank Scale-up Unit to support them in their continued growth – just as the wider business community would benefit from a Scale-ups Unit.

To encourage appropriate ambition from the unit, and to hold its feet to the fire on delivery, it should set clear deliverable targets. Our proposal is that the unit be given a mission of creating an additional £50bn in public market cap value from UK growth startups over the next 5 years by 2028.

The Government should identify key sectors to prioritise for the UK, and shape policies aimed at encouraging scale-up company growth around these industries

An ongoing challenge with economic policy in the UK, which we have encountered throughout this report, is a lack of joined-up strategic thinking. Too often policymakers have been unable or unwilling to take a full and frank look at the UK's strengths and limitations, assess global market trends, identify where the country's comparative advantages lie and fully support those industries. That failure needs to be addressed to give Britain's businesses the greatest chance of success.

The Government – in concert with the Scale-up Unit – should identify industries where the UK has, or has the potential to develop, comparative advantages in globally important sectors. These industries might include green/climate science, fintech, life sciences, data science, AI, therapeutic care services, hospitality, tourism, creative and performing arts.

Having identified the sectors where the UK genuinely has the ability to be world leading, the UK Government should identify geographic clusters of high innovation businesses that have the greatest potential to be world-leading. For each of these clusters, local and national government should identify the chief limiting factors on growth – be they finance, human capital, physical investment or regulations – and address them directly.

The following policy recommendations listed in this section should be delivered by a national government with the aim of improving the growth of scale-ups up and down the country. However, each proposal given in this section should be guided by the ambition to encourage the development of these industry clusters of innovative businesses, creating 'hubs' of similar highly innovative scale-up businesses. So, in proto-clusters which lack skilled labour, boosting access to talent through investment in tertiary education and facilitating visas should be the priority. Those areas that lack investors should be priority focus for British Business Bank investment. Those places where people lack homes and businesses lack premises should be prioritised for planning reforms.

Attracting the best global talent and facilitating visas

As this paper has explained, since the UK's departure from the European Union, firms have faced greater challenges in accessing foreign talent. The replacement of free movement of labour with the UK's points-based immigration system has increased the complexity and administrative costs of hiring highly-skilled foreign workers. Initiatives such as the Scale-up Worker visa are promising steps in the right direction, but the Government should prioritise simplifying the UK's immigration system to further ease the challenges faced by scale-ups.

Specifically, the Government should move away from the current approach to employer visa sponsorship and shortage occupations, whereby workers have to meet salary and skill requirements, to one based purely on salary. This would simplify the sponsorship process and provide greater certainty to firms and workers, ensuring that employers can bring in the people they value the most, as reflected by the salary they are willing to pay. [84]

The efficiency of the existing bureaucracy should also be improved. As with the costs of the system to employers, this 'grit in the wheels' seems designed to obstruct labour immigration so as to avoid its over-use, particularly by those most likely to engage in exploitation of overseas workers.[85] Yet such obstructions also hold up the dynamic, high potential firms the Government presumably wants to support. Indeed, speed of hire is particularly valuable to fast-moving, high growth businesses, so they may be disproportionately inconvenienced. There is no reason why the sponsorship system cannot be optimised for speed and ease of use, incorporating more efficient processes and technological enhancements.

From the perspective of businesses, these changes would do a lot to ease the barriers on such firms competing in the race for global talent. The simplified and speedier process of hiring foreign workers would mean that more highly skilled foreign workers are encouraged to come and work for British scale-ups over competing firms elsewhere, alleviating the single greatest constraint on firms' growth.

Investing in shortage skills

Whilst improving the ease with which high-growth firms can attract the best and brightest foreign workers is an important short-term reform to encourage business growth, the Government should also enact longer-term reforms that boost the skills of the UK workforce. This is a challenge for the whole country, but priority must be given to filling skills gaps in priority sectors where the UK can be world-leading, such as data science and AI, fintech and tourism – and in particular, in those places where the UK can hope to build genuine 'clusters'.

It should work to develop the basic competencies, particularly digital skills, of British workers through investment in schooling improvements. In an age of digitalisation, basic digital and computing skills are some of the most sought after by scale-ups and all SMEs alike, yet many children and young people leave school without them. The Government should be focused in its investment in school education, prioritising mathematics, coding, digital literacy and science and technology teaching (STEM subjects), in order to most effectively match the skills of future workers to the needs of fast growing companies.

Education is not just for young people, however, and a substantial portion of the issues scale-ups face relate to the failure of adults in the workforce to upskill or reskill. Despite substantial changes to technology and job roles, the UK invests relatively little in adult education, compared to its international peers – though comparable data is hard to come by, the French and German governments spend over 0.25% of GDP on training, whereas the UK spends less than 0.05%.[86] Though the Government has belatedly recognised the costs of shrinking budgets over the course of the 2010s – adult skills spending is set to rise 22% between 2019/20 and 2024/25 – this will still fall short of what is needed and was delivered fairly recently. Public spending on adult education and training in 2024/25 will remain £1.3 billion short of its 2009/10 level on current plans.[87]

More resources should flow towards short courses and flexible upskilling and retraining opportunities. As one participant in our research put it, lowering the cost to employers of training their existing employees could have similar benefits to supporting apprenticeships, but with much quicker paybacks given they are likely to be on shorter courses. This could take the form of increased flexibility around the apprenticeship levy – Labour has proposed rebranding it as a 'Growth and Skills Levy' - and allowing firms to spend up to 50% of their contributions on non-apprenticeship training, including modular courses.[88] Alternatively, that funding could be redirected to education providers such as colleges to subsidise retraining and upskilling. Either way, it would nudge employers to do more with their workers.

The UK also has a long-recognised challenge with higher technical qualifications – the 'missing middle' of courses such as higher national certificates and diplomas and apprenticeships that fall between upper secondary and higher education and tend to be vocational in nature. Such qualifications are much more common in countries like Australia and New Zealand, and their absence is seen as an explanation for Britain's skills challenges.[89]

Changes to education funding and policy – particularly the development of the Lifelong Loan Entitlement (LLE) – have the potential to address these problems. To achieve its potential, this may involve specific tweaks – for example, providing maintenance support to help people fund additional studies, or relaxing restrictions the Equivalent or Lower Qualification (ELQ) rule that prevents people from accessing funding for retraining to the same level as a qualification they have previously achieved. Improvements in adult careers guidance and support will be particularly critical.

Yet to be successful, such changes need adequate investment from government, and appropriate engagement and collaboration between employers and educational institutions. In particular, it is incumbent upon businesses that say they don't have enough skilled workers to help develop the skilled workforce of the future. Directly, they could do more to support the development of their staff.[90] They can also work more closely with educational institutions – participating with Careers Hubs[91], and organisations like Founders4Schools[92] and Speakers for Schools[93] to improve career guidance.

More businesses – especially businesses with growth ambitions – should also participate in skills policy, particularly Local Skills Improvement Plans, recently established forums through which they can influence training investments in their area.[94] While there are plenty of employer representative bodies – chambers of commerce, Federation of Small Businesses, Confederation of British Industry seeking to represent firms' interests in the skills system – for some organisations there will be no substitute for direct communication of their knowledge and needs.

Having said all this about reforming and supporting overall national structures, in a funding-constrained world, it is likely that the Government is going to have to prioritise carefully in terms of the skills and training support that it offers. That requires some degree of targeting of particular locations and sectors – emerging clusters – where the UK can be world class. Thus, for example, while digital education is valuable for high growth companies everywhere, it is likely to be particularly important in places such as Cambridge which has a relatively strong tech sector, or Gloucestershire, which specialises in cyber security. With the Scale-Up Unit having identified clusters of globally important innovative business, the Government should shape skills policy in those areas – particularly in colleges, universities and adult education - to ensure the skills of local workers match the needs of local high growth businesses and encouraging the development of local 'hubs' of scale-up companies.

Examples of key sectors proposed by participants in our roundtable spanned climate science – drawing on the example of Qatar's $4Bn green research hub in terms of scale and focus – along with fintech, life sciences and data science/AI. Beyond these high profile sectors that tend to win political interest, one participant stressed the need to catalyse other service sectors where the UK has developed advanced competencies, notably in therapeutic care services (including childcare and senior care), hospitality and tourism, and in the creative and performing arts.

Investing in training and development for these sectors would benefit the UK economy both in services offered domestically and as a training offer for visiting international students. For each regional hub selected as a centre of excellence for a given sector, the resource requirement will include a significant increase – probably tripling – in research spending; scaling the size of local university training facilities, especially for adult education; recruiting the best PhDs and other subject area talent for the sector; and aligning this training and education resource with the wider investment and infrastructure being coordinated by the British Business Bank and the proposed Scale-Up Businesses Unit.

Making it easier for firms to access growth capital

Although access to finance is, we argue, no longer the greatest barrier on the scaling of small and medium-sized enterprises, access remains difficult for many and the Government could take steps to make it easier for firms to access the capital they need to expand.

The British Business Bank should take on an enhanced role as an organisation seeking to create more equity financing opportunities and to spread those opportunities more evenly around the country.[95] While the UK could benefit from more equity finance, the greater issue is regional variation in finance. To achieve both, the Government should reshape the role of the British Business Bank, changing its mandate to prioritise the reduction of the regional equity gap as its core objective and giving the organisation greater operational independence to ramp up its investment activity. The British Business Bank has also shown that public investment can be deployed effectively: as of last year, it had supported 19 of 33 British 'unicorns' and the value of its investments has increased by 51%. However, the British Business Bank's equity investments are as London-dominated as the wider market.[96] To provide the Bank with greater independence, the Government should extend the Bank's annual review period, as set forth in Jim O'Neill's 'Start-Up, Scale-Up' review. Doing so will allow the British Business Bank to conduct longer term planning, enabling it to become more ambitious in its investments and providing greater certainty to the firms benefiting from its involvement.

Additionally, the Bank's focus should be reshaped to make more targeted investments, as outlined above in Recommendation 5, with separate funds aligned to prospective economic 'clusters' – key sectors in specific locations that have the potential to develop world-class businesses, as identified by the Scale-ups Unit. Aligning investment activity to clusters of high growth businesses will complement the Government's efforts to match skills policy to foster the growth of these businesses.

We have already suggested that existing funding aimed at supporting innovation and entrepreneurship – schemes like EIS, SEIS and R&D credits – should be reviewed to demonstrate their return on investment. These funds could potentially be redirected through the British Business Bank to support company growth and foster successful clusters.

Reforming planning

As we have seen, excessively tight planning restrictions choke both the growth prospects of highly innovative growing businesses and the local economies that are their homes. Making it easier for firms to develop the premises they need will improve their competitiveness and better enable them to expand. Furthermore, if local areas can build more homes, thus increasing the size of the pool of labour scale-ups have access to, they will find it easier to source the talent they need to thrive.[97] The shortage of housing (it was recently estimated that there are 4.3 million homes fewer than there ought to be)[98] pushes up housing costs, which in turn pushes up wage demands of workers, increasing business costs. A lack of affordable housing in the right places prevents scale-ups from accessing the most talented and skilled workers. As such, enabling the building of more houses helps scale-ups overcome the most pressing barrier they face: a shortage of adequately talented and skilled labour.

The Government should embark on a program of wholesale planning reform, moving from a discretionary planning system towards a system of locally-developed rules-based planning. Doing this will create considerably more certainty for developers, who will react by building more homes and commercial premises in places where they are needed. Planning reform of this sort should be accompanied by a liberalisation of rules around development on green belt land, especially in highly productive places such as London, Oxford and Cambridge. This will allow firms to benefit from the existing clusters of knowledge-intensive industries and cutting-edge research institutions, and will help generate agglomeration effects in urban areas that highly innovative companies seek when deciding on where to locate. These reforms will allow the development of more business and residential space, and will not only tackle one the major barriers to growth, but help tackle one of the country's greatest supply-side constraints on economic growth.[99]

As with skills, finance and migration, these are challenges to be addressed nationally. However, in the short term to get 'quick wins', the government should prioritise easing planning restrictions in potential clusters, focusing on building homes so they can attract workers and making it easier for businesses to develop the premises that they need.

By reforming procurement and regulation, the Government should foster a culture of mutual support between the state and companies

The Government should acknowledge the active role it can play in encouraging innovation and enabling scale-ups to succeed. It should first consider how its interaction with private sector suppliers can shape the growth of UK scale-ups. Bureaucracy and regulation, a failure to advertise tenders in a timely fashion and unreasonable requirements on contractors are all issues that should be addressed to make the process more friendly to growth firms. The Government should seek to make the process of accessing government contracts more of a 'level playing field' for smaller firms, and public sector bodies should exhibit a greater appetite for risk. It should also seek to create a regulatory framework for high growth industries that, whilst ensuring the protection of the public and vulnerable groups, encourages innovation and the development of high-innovation companies of tomorrow.

A significant challenge here is data, and specifically identifying, targeting and reporting on accessibility to firms. In order to ensure procurement is sufficiently friendly, the Scale-ups Unit proposed earlier should develop a 'kitemark' for firms that are officially classified as such, and state bodies should be encouraged to monitor and disclose the share of their tenders that go to certified scale-ups.

As noted earlier, government should work with Britain's largest corporations, encouraging them to voluntarily grow the extent they trade with smaller firms. It could do this in various ways: in the first instance, it could try to broker voluntary agreements or pledges from big British firms to try and foster the scale-up ecosystem around them. The recent 'Mansion House compact' to unlock investment for institutional investors in high-growth firms shows what can be achieved by getting key stakeholders round a table and using the power of persuasion.[100] We envisage the Scale-up Unit being well placed to exercise gentle encouragement or pressure on firms in this way, using its kitemark and related data.

The Government could support in other ways too. We have already suggested that it should review public sector procurement processes. It could use the learnings from that process to advise private firms seeking to be more accessible to scale-up suppliers – for example, setting up model frameworks for procurement.

Success in this agenda should be mutually beneficial. Smaller companies and scale-ups see new routes for expansion opened up, whilst bigger ones benefit from innovations they might have previously overlooked.

Remove barriers to university spin outs by standardizing agreements with universities

While reviewing the relationship between the state and scale-ups, the Government should also look closer at the incentives for university spin outs. Many people argue that universities take too much equity in businesses started by their faculty and students, with one analysis finding that the average institutional stake is 24% in the UK, compared to 7-10% for elite US universities.[101] There is some evidence to suggest that this has a negative effect on spinout success: it has been estimated that a 10% larger university stake decreases the chances of winning venture capital investment by 3%.[102] It is encouraging, then, that the Government has launched a review into university spin outs.[103]

Specifically, the Government should remove barriers to university spin outs by standardising agreements with universities. We will not specify here the precise equity share that is appropriate for a university to take, but it is reasonable that universities should take a smaller share – for example, 5-10%, in companies founded by their staff – and even less (perhaps nothing) in student-founded firms.

The Government should increase funding for schemes like Be the Business to enhance their capacity to provide training and mentoring for growing companies

Given the importance of management and leadership skills to business success – organisations that abide by management best practice have been shown to be considerably more productive on average[104] – developing those skills should be a priority for policy. The Government should seek to provide greater opportunities for scale-ups to access mentoring and training programs for senior staff as their businesses grow, and leaders in the wider business ecosystem should help scale-ups benefit from their acquired skill and experience.

Be the Business, an organisation set up with government support in 2017 to produce research and provide advice for SMEs to improve their productivity, is well placed to take on an enhanced role to carry out this objective.[105] It currently offers SME business leaders mentoring programmes that aim to develop leadership skills, offers guidance to SME firms in a variety of ways and helps connect them with other organisations that can assist their development. One of their mentoring programmes, Mentoring for Growth (MfG), connects SME leaders with business leaders from top-tier firms, aiming to improve the management and leadership capabilities of mentees and, as a result, improve firm-level performance and productivity. Research has demonstrated the effectiveness of this scheme, with considerable impacts on turnover and employment growth relative to similar unsupported companies.[106]

Be the Business is not alone in this mission, and there are several other organisations seeking to improve leadership and management capacity that ought to be considered for public support. The ultimate objective should be to build a thriving ecosystem of support services for leaders so that they can find what works best for them, and to drive innovation and experimentation in approach and methods. The Innovate UK EDGE programme has guided leaders through a range of management challenges, including finance, mergers and acquisitions, international markets, intellectual property, supply chains, leadership and talent management. It has been demonstrated to generate £12.20 in value for every £1 spent on the programme.[107] Other organisations like Digital Boost connect entrepreneurs with more experienced businesspeople for 1:1 mentorship and business support. Accessing such business support programmes could be made easier by developing stronger branding, networks and perhaps even a ‘one stop shop’ model. Singapore’s Startup SG, and Bpifrance may offer examples to learn from.[108] The Government should build on the successes of programmes such as these, and expand their capability to deliver mentoring, training and guidance to business leaders. That should helping tackle the deficit in management and leadership skills, and support future growth.

The UK as a society should seek to promote greater ambition

A common theme in our roundtable was the need for a stronger pipeline of entrepreneurially minded people. One of the best ways to develop that pipeline is by directly encouraging young people to start businesses, explaining what that entails, and ensuring they have appropriate mentoring support throughout their entrepreneurial journey. One example of this which OakNorth, the sponsor of this report, helps support is the 'Mentorpreneurship Programme' with the London School of Economics' home for entrepreneurship, LSE Generate. The Programme is the first university-run initiative of its kind to engage past, current, and future student entrepreneurs in a 'life-cycle' of mentoring. LSE alumni mentor university student entrepreneurs, who in turn mentor high school budding entrepreneurs, and a pilot scheme working with state and independent schools is being expanded to include age groups of 11-13 and 14-16 years. There is considerable scope for a greater role in mentoring programmes aimed at young people in other universities and throughout the education system.

That should be part of a broader societal effort to do more to promote ambition in the UK. Cultural change is not something that policymakers can achieve by fiat, but rather something that all of us in society need to work towards. That will involve shifting what we value and celebrate, sharing and emphasising success stories and talking more about the achievements of our greatest businesses. The media may have a particularly important role to play in terms of the stories it prioritises and the tone of its coverage.

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