



Medium-sized businesses and Welsh business structure

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Executive Summary

This report examines business structure in Wales and the role of medium-sized firms in particular. It seeks to study whether Wales has 'enough' medium-sized firms and whether these companies should be a focus for financial interventions as SME support is strongly focused on micro-small firms and start-ups.

This focus on medium-sized firms has been partly motivated by previous studies that have suggested that there might be a 'missing middle', (a lack) of medium-sized firms in Wales.

The report outlines the important data issues that need to be considered in the analysis of the business population in Wales. Different data sources vary in their coverage of business activity. Data provided by the Welsh Government's Size Analysis of Welsh Businesses shows there to be 2,155 medium-sized firms in Wales in 2018. This data includes firms registered in Wales, as well as those registered elsewhere but with significant operations in Wales. Whilst this is the official data source for the business population in Wales, the data is not suitable for comparison of Wales with other areas of the UK.

Data provided by the UK Department for Business Energy and Industrial Strategy (BEIS) is produced consistently across the UK and can be used for comparative purposes. BEIS data shows there to be around 1,300 medium-sized firms in Wales. This data source does not include firms who are registered outside Wales but which have business operations in Wales.



Wales has a similar share of medium-sized firm in enterprise count, and higher contribution to employment and turnover, compared to the UK average; however the UK lags behind some EU countries.

Previous research suggests there is no optimal business structure. Importantly, definitions of dividing lines between small, medium and large firms are heavily contested.

The report presents comparisons between Wales and the UK and other devolved administrations and regions, as well as between the UK and EU countries. The comparisons are in terms of the number of firms of a particular size, their share in employment and turnover, the distribution of enterprises in particular sectors and places, and the performance of companies of different size classes in terms of productivity. The report also considers factors influencing business dynamism.

In comparison to the UK and other devolved administrations, there is no 'missing middle' in terms of the proportion of medium-sized firms in the business count in Wales. Wales, in similarity to other parts of the UK, has a relatively small number of medium (and large) firms in the business structure compared to smaller firms, and by virtue of their size, these firms make a disproportionately important contribution to the economy in terms of turnover, employment and productivity.

However the report has found that medium-sized enterprises have recorded relatively low rates of growth in enterprise count and share during the past five years, providing some evidence of low rates of business evolution into medium-sized firms.

Executive Summary

There are also productivity gaps between Wales and the UK across all size bands of firm (including within the medium-sized group) and by industry. Turnover per employee in Wales lagging that of UK firms. An important industry exception is production, where micro and medium-sized firms in Wales outperformed the UK average in terms of turnover per employee in 2018.

This report suggests that in the contemporary Welsh economy, it is important for interventions to encourage productivity growth and innovation irrespective of firm size.

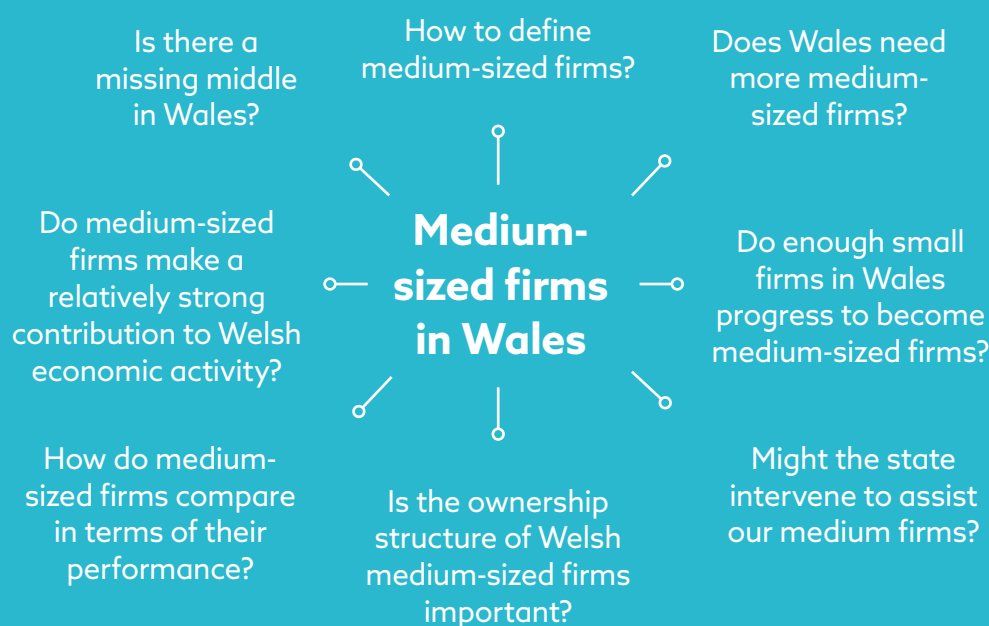
Whilst there was relatively strong turnover growth overall within the medium-sized group

of firms, the report found that this growth was concentrated in a small number of enterprises, which then have the potential to progress to a larger firm (employment) size. A larger number of medium-sized firms were shown to have experienced low or negative growth.

The report identified a number of factors that influence firm dynamism in Wales. Important amongst these factors are the low growth ambitions of many SMEs, with this linking to a range of other factors including funding issues, and awareness of government interventions. A number of factors external to the firm will also influence business dynamism. These include structural issues and historic factors.

Through analysis of medium-sized firms in Wales, a number of further research questions have emerged, relating more specifically to the characteristics and potential impacts of these, and other firms within Wales.

Medium-sized firms - selected research questions.



Future research in Wales should explore issues of ownership and control, and the consequences for the local economy, particularly in terms of skills development, finance demands, and local purchasing behaviour. This would seem to be particularly important as interest grows in the concept of the foundational economy.

Key SME research questions are the dynamics of firm sizes, for example, how many medium-sized firms succeed in becoming large firms and what happens to business growth prospects if firms get taken over by external firms. These issues will be explored in an EIW report during 2020.

This report examines business structure in Wales and the role of medium-sized firms in particular. This focus has been partly motivated by previous studies that have suggested that there might be a 'missing middle', (a lack) of medium-sized firms in Wales.¹

In addition, due to their larger size, and linked prospects for higher productivity, innovation and growth, this cohort of firms have particular potential importance to the Welsh economy and merit investigation.

Over 99% of firms in Wales are categorised as small and medium-sized enterprises (SMEs). SMEs are defined as enterprises that employ up to 250 employees and have an annual turnover of less than €50 million.² Within this broad SME definition, micros are those which employ up to 9 people, while smalls have 10 to 49 employees, with medium-sized firms employing 50 to 249 people.

SMEs constitute a particularly heterogeneous group with micro, small and medium-sized firms having different characteristics and needs. Indeed, even firms falling into the medium size category can be multinational firms in their own right. There is also a need to consider certain qualitative aspects of an enterprise. For instance, a small company in the 'fintech' sector or in digital technologies could be considered as a medium-sized enterprise, in terms of its productivity or economic dynamism, while a micro company that exports or employs e-commerce could be a transnational corporation. Consequently, the definition of SMEs is often contested.

This report provides evidence on the contribution of medium-sized firms to the Welsh economy, and the related implications. The findings are used to consider:

How Wales compares with other parts of the UK and EU in terms of the number and significance of medium-sized firms.

If medium-sized firms should be a focus for government interventions as SME support is strongly focused on micro-small firms and start-ups.

The next section of this report reviews research on the importance of medium-sized firms in business demography, and highlights the general factors that determine business growth. This section also considers problems of definition of SME size classes.

Section 3 provides some comparative analysis of the significance of firms of different size classes between parts of the UK and European Union and seeks some broad conclusions on whether Wales is under- or over-represented in terms of the volume of economic activity undertaken in medium-sized enterprises.

Section 4 explores the performance of firms of different employment size classes in Wales in terms of profitability, productivity and growth.

Section 5 suggests some factors that influence the firm size distribution and business evolution prospects in Wales. Section 6 presents the conclusions and recommendations for further research.

¹ See for example, FSB (2017). Wales' missing middle. Available from: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb_missing_middle_eng.pdf?sfvrsn=0; also see Institute of Welsh Affairs (2015). An economic strategy for Wales? Available from: http://www.iwa.wales/click/wp-content/uploads/IWA_EconomicStrategyforWales.pdf

² European Commission (2003). Commission Recommendation 2003/361/EC. Official Journal of the European Union L124, 36-41.

2.1. Firm size distribution in a regional economy

Firm heterogeneity, in terms of size, location, sector and productivity, is an inevitable implication of competition, innovation and profit seeking in a market economy.³ Firms seek competitive advantage by adopting routines that are largely idiosyncratic, and firms, even in closely related industries, have very different growth trajectories, and population dynamics in terms of new entry, exit, and mergers.

Heterogeneity of the business structure is a common and important feature of a healthy regional economy⁴ and can be linked to export performance and productivity growth.⁵ However, in addition to the importance of heterogeneity there is an equally important issue of the dynamism of regional business populations, for example, movement of firms between size classes, and fluidity in new starts and firm exits.⁶ A 'non-dynamic' population could result in a decline in employment and productivity growth.⁷ Fluid evolution of business populations results in better opportunities for international trade and export growth.⁸

Inertial pressures, through competition, specialisation and selection, affect enterprise replacement rates and thus firm size distribution.⁹ Differences in the take-up of learning and innovative adaptation increase chances of survival. Consequently in an environment with resource constraints not all firms manage to grow. Medium-sized firms can face competition from new entrants and established large firms. In such cases, medium-sized firms in one period either go on to become the new large players, or die out of the population being replaced by a new set of medium-sized industry players.¹⁰ A further possibility is that some medium-sized firms may just stagnate through a lack of ambition.

Firm size and transactions costs in economies of scale and scope

The Bolton Report (1971) highlighted the growing dominance of large firms in the UK economy, increases in both aggregate and market concentration levels, and the expected squeezing out of smaller firms as economies of scale became more and more important. However, the SME sector as a whole has been far more resilient than was expected 40-50 years ago. SME growth trends have been very pronounced throughout the UK.

³ Essletzbichler, J. and Rigby, L. (2007). Exploring evolutionary economic geographies. *Journal of Economic Geography* 7, 549-571.

⁴ Bartelsman, E. and Doms, M. (2000). Understanding Productivity: Lessons from Longitudinal Microdata. *Journal of Economic Literature*, 38, 569-594.

⁵ Melitz, M. (2003). The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity. *Econometrica* 71, 1695-1725.

⁶ Storey, D.J. (1994). *Understanding the Small Business Sector*. London: Routledge.

⁷ Luttmer, E. (2007) Selection, Growth, and the Size Distribution of Firms. *The Quarterly Journal of Economics* 122, 1103-1144.

⁸ Melitz, M. (2003). The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity. *Econometrica* 71, 1695-1725.

⁹ Hannan, M. and Freeman, J. (1977). The population ecology of organizations. *American Journal of Sociology* 82, 929-64.

¹⁰ MacArthur, R. (1972). *Geographical Ecology: Patterns in the Distribution of Species*. Princeton, N.J.: Princeton University Press.

2.1. Firm size distribution in a regional economy

Prior research reveals that there is no optimal firm size distribution; therefore it is difficult to argue whether an increase in the number of medium-sized firms in an industry is a good or bad development.

However, there is a role for medium-sized firms in terms of a contribution to regional economic growth, employment, and innovation.¹¹ Research has revealed that medium-sized firms can be more resilient than smaller firms. Their size suggests greater financial resources, higher export propensity and greater diversity within the firm, thus boosting survival prospects.¹² Their size entails easier access to external

finance compared with smaller firms, partly as a result of the funders' increased access to soft information on these businesses. But it is often smaller firms, despite their relative lack of resources and information, that are identified as more innovation intensive, and less bound by path dependencies that shape decisions in larger more established firms.¹³ Additionally, small businesses play an important role in employment by creating jobs in peripheral regions. This reinforces the above conclusion that heterogeneity of the business structure is a common and potentially important feature of a healthy regional economy.

¹¹ Kamal-Chaoui, L. (2018). Better policies for SMEs to scale up and go global. Available from: http://oecdobserver.org/news/fullstory.php/aid/6021/Better_policies_for_SMEs_to_scale_up_and_go_global.html

¹² McPherson, M. (1995). The Hazards of Small Firms in Southern Africa. *The Journal of Development Studies*, 32(1), 253-277.

¹³ Baumol, W. (2004). Entrepreneurial Enterprises, Large Established Firms and Other Components of the Free-Market Growth Machine. *Small Business Economics* 23, 9-21.

2.2. Factors of business evolution

The determinants of firm size distribution in a business population are closely related to the factors determining firm size growth.¹⁴ Gibrat's law (1931)¹⁵ shows that growth rates are not dependent on firm size. Indeed some evidence suggests a negative relationship between firm size and growth, with exit rates declining with firm size.¹⁶

Firm age is intertwined with changes in firm demography. Firm size distribution within an industry is affected by the stage of the industry in its life-cycle and the maturity of the sector.¹⁷ More generally, the whole range of factors that affect business growth (for example, entrepreneur's characteristics, resource availability, specific industry socio-economic and spatial factors¹⁸) are linked to the size distribution of firms in an industry. In this latter respect, economic and industrial policies, including interventions to help start-ups, and help to encourage fast growth small firms, will influence the size distribution of firms.¹⁹

Policies related to taxation, credit markets, and employment rights, as well as institutional factors that affect the level of transactions costs such as the degree of property rights' protection and the level of bureaucracy also influence the size distribution of firms.²⁰

Finance constraints are also expected to have subtle impacts on the size distribution of firms, for example, credit rationing and uneven access to funding.²¹ Issues related to funding are also a consequence of the demand side, with small firms not always seeking external finance, due to low growth ambitions, fear of ceding control of the company and a reluctance to service debt. Moreover high costs of capital and poor availability of credit pose barriers on small firm growth and to the number of small firms that grow and become medium-sized and large firms.²²

¹⁴ Angelini, P. and Generale, A. (2008). On the evolution of firm size distributions. *American Economic Review*, 98, 426-438.

¹⁵ Gibrat, R. (1931). *Les inegalites economiques. Applications: Aux inegalites des richesses, a la concentration des entreprises, aux populations des villes, aux statistiques des familles, etc., d'une loi nouvelle: La loi de l'effect proportionnel*. Paris: Sirey.

¹⁶ Bartlett, W. and Bukvič, V. (2001). Barriers to SME Growth in Slovenia. *MOST: Economic Policy in Transitional Economies*, 11(2), 177-195.

¹⁷ Dinlersoz, E. and MacDonald, G. (2009). The industry life-cycle of the size distribution of firms. *Review of Economic Dynamics* 12, 648-667.

¹⁸ Liedholm, C. (2002) Small Firm Dynamics: Evidence from Africa and Latin America. *Small Business Economics*, 18, 225-240.

¹⁹ Henrekson, M. and Johansson, D. (1999). Institutional Effects on the Evolution of the Size Distribution of Firms. *Small Business Economics* 12, 11-23.

²⁰ Desai, M., Gompers, P. and Lerner, J. (2003). Institutions, Capital Constraints and Entrepreneurial Firm Dynamics: Evidence from Europe. National Bureau of Economic Research Working Paper No. 10165.

²¹ For a review see: Angelini, P. and Generale, A. (2008). On the evolution of firm size distributions. *American Economic Review* 98, 426-438.

²² Rajan, R. and Zingales, L. (1998). Financial Dependence and Growth. *American Economic Review*, 88, 559-86.

²³ Martin, R. and Sunley, P. (2006). Path Dependence and Regional economic evolution. *Journal of Economic Geography* 6, 395-437.

There are also historical influences placing constraints on development. The evolutionary theory of the firm suggests that processes of path dependence shape the way that firms make decisions, and can work to create a lock-in to a given development path.²³ The impact of past events and decisions occurs through various mechanisms within the firm,

its industry, and the external environment, and may lead to firms being locked into adverse pathways. These path dependencies writ large can also shape regional economic development prospects. Choices and practices of the past, including technologies and produce design, labour skills based on learning process, strongly affect the choices in the following period.

2.3. Conclusion

The review suggests that there is no optimal business structure for an economy and indeed that heterogeneity is an important and healthy feature of a regional economy. Of importance, however, are the characteristics of firms of different sizes within an economy, and the

dynamism of movements within and between size classes, and of new firm starts and exits. Business growth, and the factors that effect growth, will then link through to the size distribution of firms within an economy.

3.1. How many medium-sized firms does Wales have?

There is no clear answer to this question, with different statistical sources presenting different conclusions. A detailed analysis of the differences between statistical sources is beyond the scope of this report.²⁴ However, a critical issue is differences in the business count for Wales in estimates provided as part of the BEIS (UK Department for Business Energy and Industrial Strategy) Business Population Estimates, and data available in the Welsh Government's Size Analysis of Welsh Businesses. For example, in the case of medium-sized firms, BEIS Business Population estimates show around 1,300 in Wales, while Welsh Government data reveals estimates in excess of 2,100 (Table 1).

Key reasons for these differences in respect of the medium-sized firm count in particular include the following:

- BEIS Business Population Estimates for Wales do not include all private sector employers in Wales.
- BEIS Business Population Estimates do not take into account enterprises registered outside of Wales but with activity within Wales. Such Business Population estimates of medium-sized firms based on employment then tally quite well with Companies House data on firms with registered offices in Wales.
- BEIS Business Population Estimates exclude charities and non-profit enterprises which account for an estimated 3,800 VAT/PAYE registered enterprises in Wales, employing around 85,000 people.

Table 1. Enterprise count, BEIS Business Population Estimates and Welsh Government's Size Analysis of Welsh Businesses, 2018.



	No employees	Micro	Small	Medium	Large	Total
BEIS	144,070	44,705	8,345	1,295	220	198,635
Welsh Government	198,655	47,350	9,365	2,155	1,675	259,200

Source: BEIS Business Population Estimates

As a consequence of the above points, the Welsh Government's *Size Analysis of Welsh Businesses*, and data held on the Stats Wales database, provides a better indication of the private business stock in Wales, by including more activity of firms registered elsewhere in the UK, but having significant activity in Wales. Of course this creates a further set of issues in terms of 'What is a Welsh firm?' The differentiation between firms registered and operating in Wales from firms registered elsewhere with operations in Wales is an important one.

For example, these types of differences might link to the absence of headquarter type activity in Wales, which is discussed later in this report.

Following from the above discussion, when comparing the characteristics of medium-sized firms in Wales with those in other regions it is more appropriate to use either BEIS Business Population Estimates or ONS Business or Demography statistics. This is the approach adopted in this section when inter-regional comparison is undertaken.

²⁴ See the following weblink for a helpful summary of the different coverage of medium-sized firms by statistical source <https://gov.wales/sites/default/files/statistics-and-research/2018-12/181129-size-analysis-welsh-business-2018-en.pdf> but the reader is also directed to the ONS Guide to the Business Population and Demographics Statistics Publications at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/16418/guide_to_the_uk_business_population_and_demography.pdf

3.2. How important are medium-sized firms in Wales?

One of the purposes of this section is to examine whether Wales has an over-or under-representation of private sector firms in different size classes. In this report, business size is measured on an employment basis. Some of the issues of using employment size to classify firms were outlined in section one of this report.

According to the Stats Wales data there were 2,155 active medium-sized firms in Wales in 2018, representing 0.8% of the population of active enterprises. As noted above, this data source does not enable comparisons across the UK. Following from the discussion in Section 3.1 the first set of tables in this section of the report therefore use the BEIS Business Population Estimates of business demography which cover a smaller set of medium-sized enterprises.

According to the BEIS Business Population Estimates 2018, medium-sized enterprises in Wales accounted for 0.7% of the business count, which is close to the UK average (Table 2). According to these estimates there were around 1,300 medium-sized firms in Wales (UK, 34,800). More detail on how the share of medium-sized enterprises varies across the UK regions is provided in Table 4, whilst Table 7 provides an analysis by size band within the medium-sized category of firms.

Table 2. Distribution of enterprises by employment size-class UK Countries and Devolved Regions 2018.



	Enterprise Count (%)			
	No employees*	Micro-Small (1-49 employees)	Medium (50-249 employees)	Large (250+ employees)
UK	75.5	23.8	0.6	0.1
England	76.0	23.3	0.6	0.1
Wales	72.5	26.7	0.7	0.1
Scotland	71.1	28.0	0.7	0.2
Northern Ireland	73.1	26.0	0.7	0.1

*group of enterprises are the self-employed with no employees (owner-only firms).

Source: BEIS Business Population Estimates see for more information <https://www.gov.uk/government/statistics/business-population-estimates-2018>

3.2. How important are medium-sized firms in Wales?

In 2018, there were 774 companies per 10,000 adults in Wales (see Table 3): 561 without any employees (owner-only firms), 207 micro and small firms, 5 medium-sized and 1 large. This compares with more than 1,050 firms for every

10,000 adults in the UK: 799 owner-only firms, 252 with 1-49 employees, 7 medium-sized, and 1 large. England and Northern Ireland (NI) have higher numbers of medium-sized enterprises per 10,000 adults than Wales and Scotland.

Table 3.
UK Countries and Devolved Regions: Companies by Firm Size per 10,000 adults 2018.



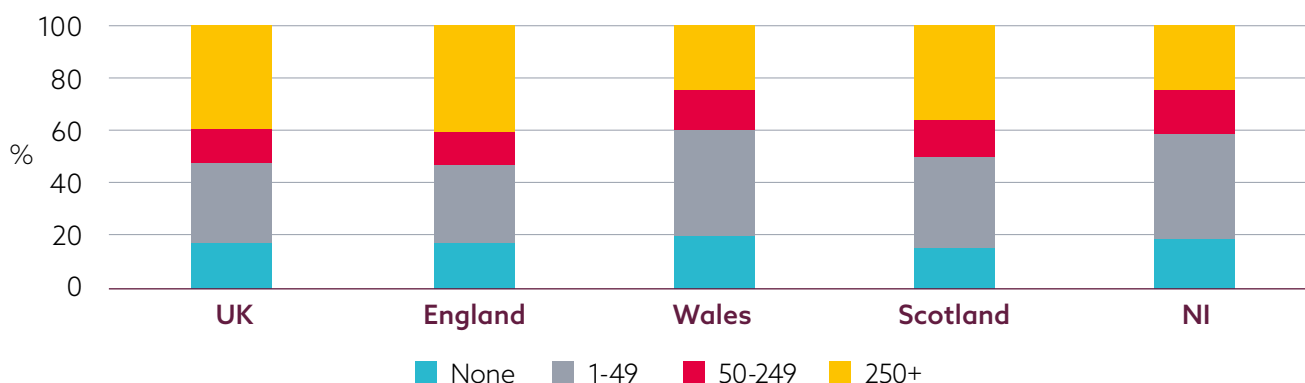
	No employees	1-49	50-249	250+	Total
UK	799	252	7	1	1,059
England	845	259	7	1	1,113
Wales	561	207	5	1	774
Scotland	522	206	5	1	735
Northern Ireland	656	233	6	1	897

Source: As Table 2

In Wales and Northern Ireland around 75% of the private sector workforce is employed by SMEs, while the comparative figure for England and Scotland is around 60%. In Wales, medium-sized firms contributed 14.9% of private sector employment.

The share of large companies in private sector employment in Wales and Northern Ireland was much smaller than in Scotland, England and the UK average (around 25% to 40%). Micro and small firms contribute around 40% to total private sector employment in Wales.

Figure 1.
Share of employment by firm size, UK countries and devolved administrations, %, 2018



Source: As Table 2

3.2. How important are medium-sized firms in Wales?

Wales and Northern Ireland record the highest SME share in total turnover. Medium-sized firms in Wales made the second greatest contribution to total turnover in their respective region, after Northern Ireland (18.3% to 21.3%). Large corporations' share in total turnover in Wales was 39%, much lower than the UK average (48%) but much higher than Northern Ireland (29%).

39%

Wales large corporations' share in total turnover

48%

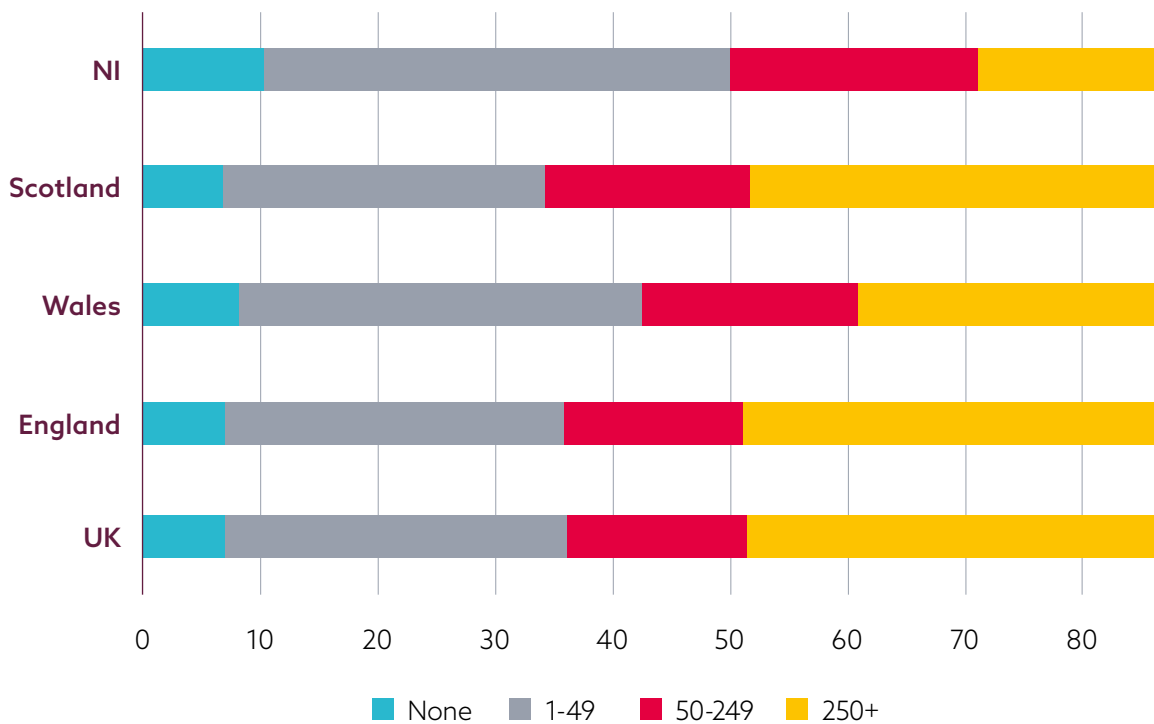
UK average large corporations' share in total turnover

29%

Northern Ireland large corporations' share in total turnover

Figure 2.

Turnover by business size class, UK countries and devolved administrations, %, 2018



Source: As Table 2

3.2. How important are medium-sized firms in Wales?

Welsh medium-sized firms, defined in terms of employment, make a slightly higher relative contribution to total employment and turnover than the UK average, while their share of the total enterprise count is similar to the other

devolved administrations and UK regions (Table 4). Table 4 marks out the important contribution made by Wales' medium-sized firms, and at one level, reveals their relative importance to Wales.

Table 4.

Summary: The contribution of medium-sized firms to private sector sales and employment, 2018.



	Enterprise Count	Turnover	Employment
UK	0.6	15.4	12.6
Wales	0.7	18.4	14.9
Scotland	0.7	17.2	13.9
Northern Ireland	0.7	21.3	16.4
England	0.6	15.1	12.3
North East	0.6	20.4	14.6
North West	0.7	16.2	14.0
Yorkshire and the Humber	0.7	15.6	13.1
East Midlands	0.6	14.3	12.3
West Midlands	0.6	12.3	11.9
East of England	0.6	13.4	10.9
London	0.6	16.7	11.3
South East	0.6	13.4	12.7
South West	0.5	17.0	13.2.

Source: As Table 2

3.3. Are medium-sized firms becoming more important for Wales?

Table 5 shows the distribution of enterprises, employment and turnover in Wales for 2018 together with changes occurring since 2013. Note here that results are reported using estimates from Welsh Government. See Table 1 for a comparison of the business count between data sources.

Table 5 reveals the numbers of medium-sized firms in Wales increased by 7% in the period 2013-18. This was below the growth in enterprise count in the smaller firm categories. The total increases in the enterprise count in Wales during 2013-18 was 17%. Total employment in Welsh enterprises increased by 11% during 2013-18, with firms in the medium-sized category experiencing an employment increase of 9%. Total business turnover in Wales fell by 0.6% during the five year period, with a significant

decline in turnover amongst owner-only firms, compared with relatively strong overall turnover growth of 19% for medium-sized firms.

7%

increase of medium-sized firms
Wales in the period 2013-18

17%

increase in the enterprise
count in Wales during 2013-18

11%

increase in employment in Welsh
enterprises during 2013-18

Table 5.

Enterprise count, employment and turnover by size band in Wales, 2018 and change 2013-18 (Welsh Government, Stats Wales).



2018	No employees	Micro	Small	Medium	Large	Total
Enterprise Count	198,655	47,350	9,365	2,155	1,675	259,200
Employment (000s)	219	180	178	142	440	1,160
Turnover (£ millions)	3,163	12,875	13,745	16,238	69,009	115,030
2013-2018 (% change)	No employees	Micro	Small	Medium	Large	Total
Enterprise Count	17.5	16.7	12.8	7.0	5.4	17.0
Employment	17.4	12.2	14.3	8.9	7.9	11.3
Turnover	-48.5	25.0	15.7	19.1	-6.4	-0.6

Source: Stats Wales 2019 see <https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/Businesses/Business-Structure/Headline-Data/latestbusinessstructureinwales-by-sizeband-measure>

3.3. Are medium-sized firms becoming more important for Wales?

Table 6, using information from Stats Wales, reveals that the share of medium-sized firms in Wales in terms of enterprise count and employment changed from 2013 to 2018 by -8.6% and -2.2% respectively, while their share of total turnover increased to 14.1%. The data appears to suggest a potential issue with fewer small businesses progressing to become medium-sized firms, since the latter recorded a lower growth in enterprise count and share between 2013 and 2018. This signals a potential issue related to the dynamism of Welsh business population.

14.1%

increase in share total turnover in Welsh enterprises

-8.6%

change in enterprise count and employment in Wales

Table 6.

Share in enterprise count, employment and turnover by size band in Wales (%), 2013 and 2018.



2018	No employees	Micro	Small	Medium	Large	Total
Enterprise Count	198,655	47,350	9,365	2,155	1,675	259,200
Employment	219	180	178	142	440	1,160
Turnover	3,163	12,875	13,745	16,238	69,009	115,030
2013-2018 (% change)	No employees	Micro	Small	Medium	Large	Total
Enterprise Count	17.5	16.7	12.8	7.0	5.4	17.0
Employment	17.4	12.2	14.3	8.9	7.9	11.3
Turnover	-48.5	25.0	15.7	19.1	-6.4	-0.6

Source: As Table 5

3.3. Are medium-sized firms becoming more important for Wales?

Table 7 shows the distribution of activity within the medium-sized group of firms in Wales and the UK. The 50-99 employee size class constitutes the vast majority of medium-sized enterprises (Wales, 67% and UK 66%), while only 5% of medium-sized firms in Wales employed 200-249 people (6% in the UK). Similarly, the 50-99 class contributed around 48% of medium-sized firm employment in Wales, and 45% of turnover. However, companies employing 100-199 people made the highest contribution to medium-sized firm turnover in the UK (44%). The distribution of firms and employment within the medium-sized group of firms, is therefore similar in Wales and across the UK, with some minor differences in turnover shares.

There are also differences in business productivity across the medium-sized grouping (as measured by turnover per employee),²⁵ and between Wales and the UK. For example, in Wales, enterprises with 200-249 employees recorded turnover per

employee of £138,000 in 2018, followed by companies with 100-199 employees (£135,580), and 50-99 employees (£122,100). In the UK, companies employing 100-199 had the highest productivity (£193,725). Issues of productivity and profitability will be discussed further in section 4. While turnover per employee varies by medium-size class, future research might also address the extent of earnings variation across medium firm size bands.

67%

of medium-sized enterprises in Wales have an employee size of 50-99

5%

of medium-sized firms in Wales employed 200-249 people

Table 7.

Enterprise count, employment and turnover share, and productivity, by size band within the medium-sized group of firms in Wales and UK, 2018.



Number of employees	Enterprise Count (%)		Employment (%)		Turnover		Turnover per employee (£)	
	UK	Wales	UK	Wales	UK	Wales	UK	Wales
50-99	66	67	47	48	41	45	154,433	122,100
100-199	28	28	40	40	44	42	193,725	135,580
200-249	6	5	13	12	14	13	191,168	138,000

Source: As Table 2

²⁵ This is just one measure of productivity, used here due to data availability. The more standard measures of labour productivity use GVA as the numerator, and are derived per hour worked for more consistent comparisons across industries and locations.

3.4. How does Wales and the UK compare within Europe in terms of the significance of medium-sized firms?

Direct comparison of Wales with EU countries is not possible due to methodological differences. The analysis in this section is limited to UK comparisons with EU countries.

However due to the similarities between Wales and the UK, in terms of medium-sized firm economic contributions, the analysis here could still provide useful information.

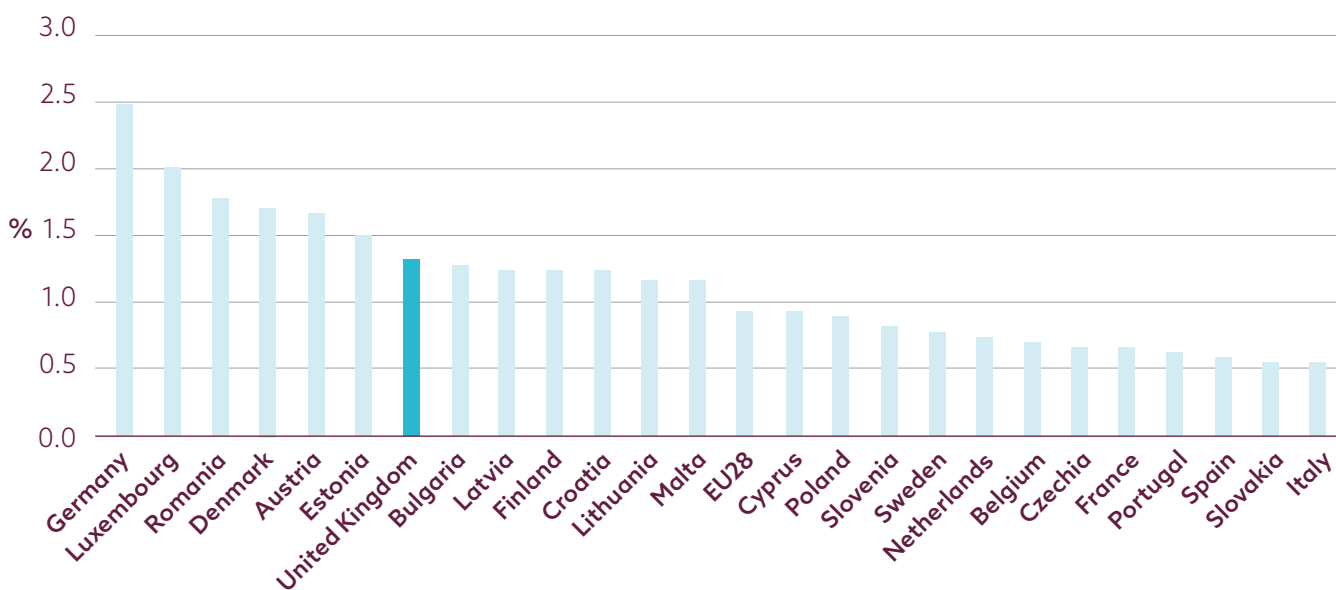
Figure 3 reveals that in terms of the medium-sized firm share of business activity (turnover and employment), the UK medium-sized firm contribution is relatively low compared to that in many EU states. Figure 3 also shows that

in terms of share of medium-sized firms in the total enterprise count that the UK has a share above the EU-28 average.

Figure 3 reveals that countries with higher proportions of medium-sized firms in the enterprise count include relatively strong economies, such as, Germany, Luxembourg, Denmark, and Austria, as well as some weaker economies, such as Romania and Estonia. Germany has been identified for its 'Mittelstand' firm which is a long-established, large and niche dominating type of medium-sized firm.²⁶

Figure 3.

Proportion of medium-sized firms in the total enterprise count, (registered businesses only) selected EU, %, 2016.



Source: Derived from Eurostat, 2019 see https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=sbs_sc_sca_r2&lang=en

²⁶ CRESC (2015). What Wales could be. Available from: <http://hummedia.manchester.ac.uk/institutes/cresc/research/Final%20Cresc-SB%20Report%20FOR%20RELEASE%20%281%29.pdf>

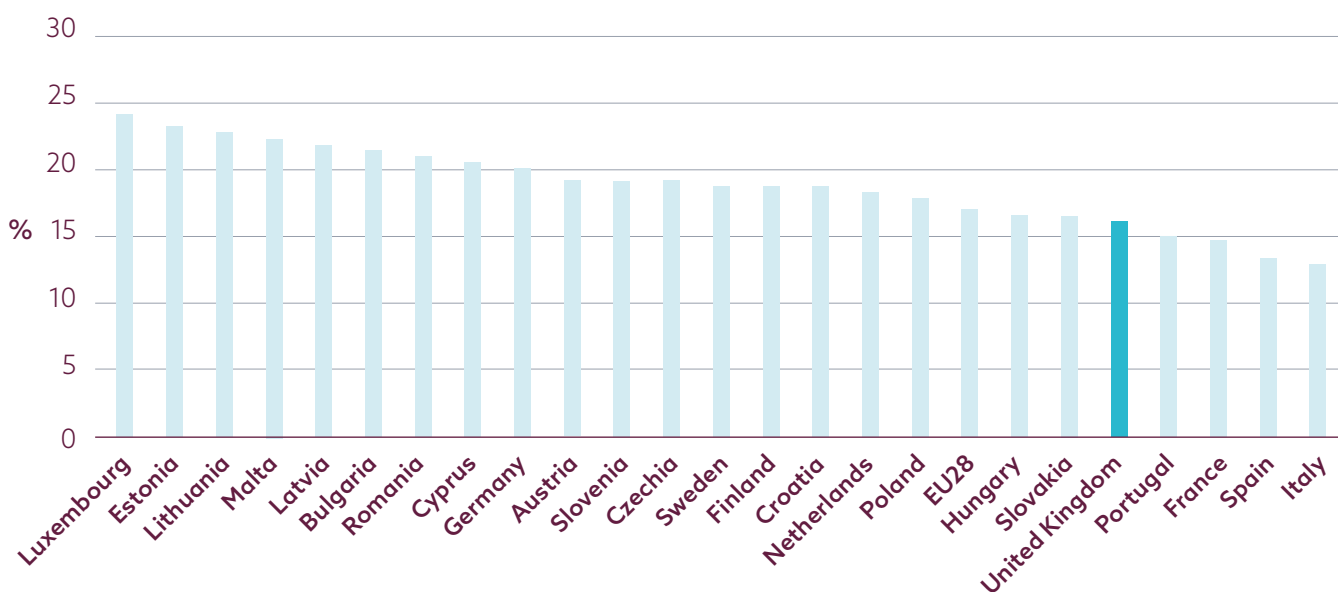
3.4. How does Wales and the UK compare within Europe in terms of the significance of medium-sized firms?

UK medium-sized firms were the fifth lowest in the EU in terms of their share in total employment (in 2016). Small economies, such as Luxembourg, Malta, and the three Baltic countries recorded the highest shares of medium-sized firms in total private sector employment. The top five economies with the highest medium-sized firm employment include

both wealthy and less wealthy EU countries. By contrast, relatively large economies had the lowest contribution of medium-sized enterprise employment to total employment. This is illustrated in Italy, Spain, France, and the UK, as these countries host many large transnational corporations which contribute significantly to total private sector employment.

Figure 4.

How medium-sized firms contribute to total employment, (registered businesses only), selected EU, %, 2016.



Source: Eurostat, 2019 as Figure 3

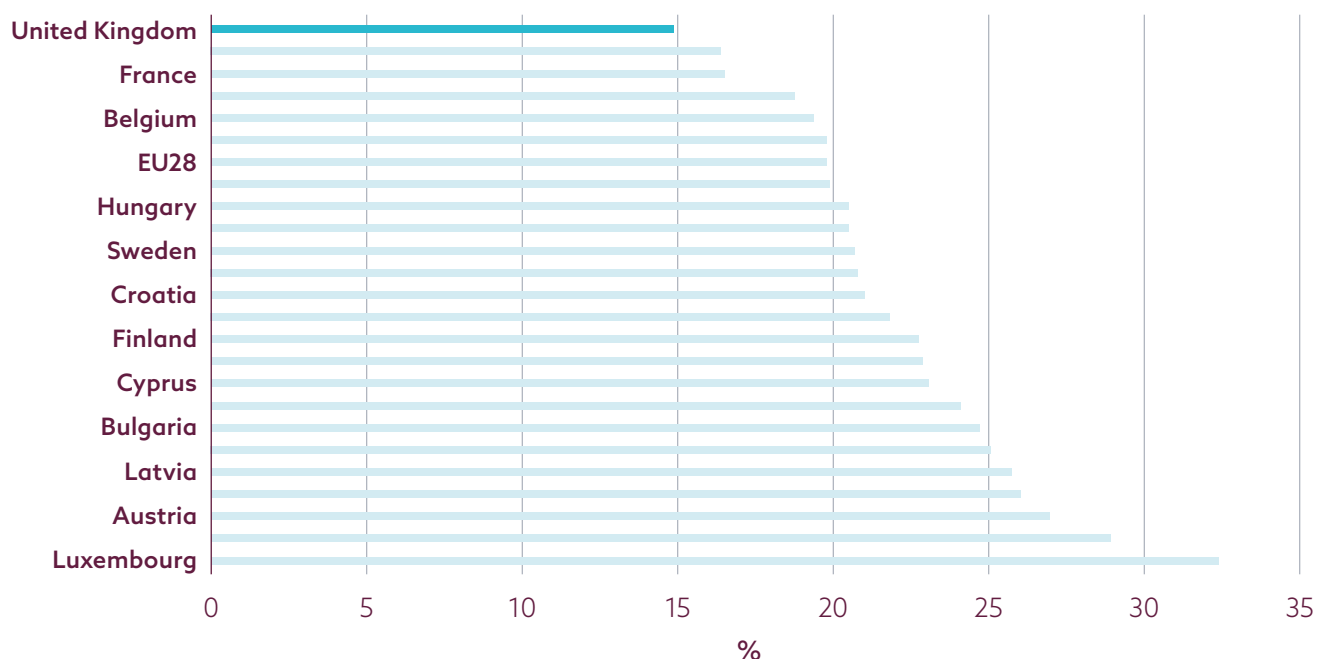
In 2016 Luxembourg had the greatest contribution of medium-sized firm's turnover in total turnover. Latvia and Lithuania are in the top five of medium-sized company turnover share, with Austria and the Netherlands, two largely wealthy countries of the EU core, having medium-sized firms making a relatively high

contribution to turnover. Although Germany is well-known for its 'Mittelstand' firm, its medium-sized firms make the ninth lowest contribution to total business turnover. The UK, together with France and Belgium, are in the bottom five in terms of medium-sized firm turnover shares of total business turnover.

3.4. How does Wales and the UK compare within Europe in terms of the significance of medium-sized firms?

Figure 5.

The contribution of medium-sized firms to total business turnover, (registered businesses only), selected EU, %, 2016.



Source: Eurostat, 2019 as Figure 3

3.5. Conclusion

This section of the report reveals that the number of firms in Wales that might be classified in employment terms as medium-sized depends somewhat on the data source employed. What is clear from this section is that medium-sized firms are an important component of the contemporary regional economy, with strong recent output growth in comparison to Welsh firms in some other employment size classes (see section 4.4 for further analysis of this). This section also raised the issue of the fluidity through which small firms grow to become medium-sized firms in Wales. This section finds that in terms of medium-sized firm share of business count, employment and output, Wales performs relatively well compared to the UK as a whole, and in comparison to many other regions.

The UK lags its counterparts in several EU countries, in terms of medium-sized firms' share in enterprise count, employment, and turnover. Countries with proportionately more medium-sized firms are both relatively stronger and weaker economies, thus providing little guide to an optimal firm size distribution in an EU context.

This section has already noted that medium-sized firms have higher levels of turnover per employee in the UK than in Wales. The next section further explores issues relating to firm performance in terms of profitability and productivity.

4.1. Firm performance by size class: Indications from Companies House data

Information from the FAME database was analysed to gain insights in performance of firms in different size classes. Here the FAME database was searched for firms in each employment cohort (micro, small and medium) with registered or primary trading office in Wales. For comparative purposes performance figures derived from FAME were compared to firms in the same size cohort in England.

There are some difficulties when computing any per employee estimates because smaller and micro-sized firms typically provide only limited accounts information to Companies House. There are also a further set of problems with such an analysis in terms of potential double counting of firms that are subsidiaries of other firms in the selection. It is important to recognise that what follows is limited to only a restricted number of firms on the FAME database (particularly those in the micro-category) who actually reported employment information, and should be seen as only indicative, and only covering one year of data.

This noted, an analysis of firms that did provide employment data in their last available accounts (and analysed in July 2019 using the FAME database) suggested that 40% of English micro enterprises were profitable, while only 34% of micro enterprises in Wales made profits. In Wales, 53% of small firms were profitable, whereas in England the rate rises to 63%. However, more medium-sized were profitable in Wales than in England (76% to 73%). The main gaps in firm profitability compared with the UK were in the micro and small size bands, and the analysis suggests possible higher rates of resilience amongst the medium-size cohort of firms in Wales.

Table 8 reports estimated median turnover per employee for the identified firms. In both England and Wales median turnover per employee increases with firm size, but Table 8 shows that the gap between small and medium-sized firms in terms of turnover per employee is larger in Wales than in England. Indeed medium-sized firms in Wales and England feature similar levels of turnover per employee (and further analysis showed that median profits per employee were also similar i.e. £2,063 in Wales and £1,864 in England). This outline analysis shows that turnover per employee in English small-sized firms was around twice that in Welsh small-sized firms, with similar differentials in the micro category.

While care is urged in taking too much from these estimates, it is noted that other sources identify the weaker performances in Welsh firms. For example, the *SME Finance Monitor 2018* revealed that a lower proportion of surveyed Welsh SMEs made profits compared to their UK counterparts. Variations in profit and turnover per employee can be linked with many factors including industry structure (see later), and then do not provide a complete picture of growth prospects. However, this data further indicates that small firms may find it more difficult to progress into medium-sized enterprises.



Table 8.
Estimated Median
Turnover per Employee²⁷.

	Micro	Small	Medium-sized
England	58,200	99,600	104,900
Wales	30,200	51,600	100,800

Source: FAME, July 2019

²⁷ Differences in the rates of part-time employment by size band between Wales and the UK may have some influence on these figures. Note these are based on last available year of financial data.

4.2 Firm productivity by employment size class across Wales

The distribution of SMEs in the Welsh economy largely follows the distribution of overall economic activity. For example, irrespective of employment size band, most Welsh SMEs are found in South East Wales; in 2018, micro (42%), small (44%), and medium-sized (57%).

Mid and South West Wales had the highest micro company density, with 894 micro businesses per 10,000 adults, while North Wales recorded the highest density in small firms (34 per 10,000 adults). South East Wales had the highest density in medium-sized firms, nearly 8 for every 10,000 residents, compared with 7 in North Wales and Mid and South West Wales.

894

micro businesses per 10,000 adults
in Mid and South West Wales

34

small firms per 10,000
adults in North Wales

8

medium-sized firms per 10,000
residents in South East Wales

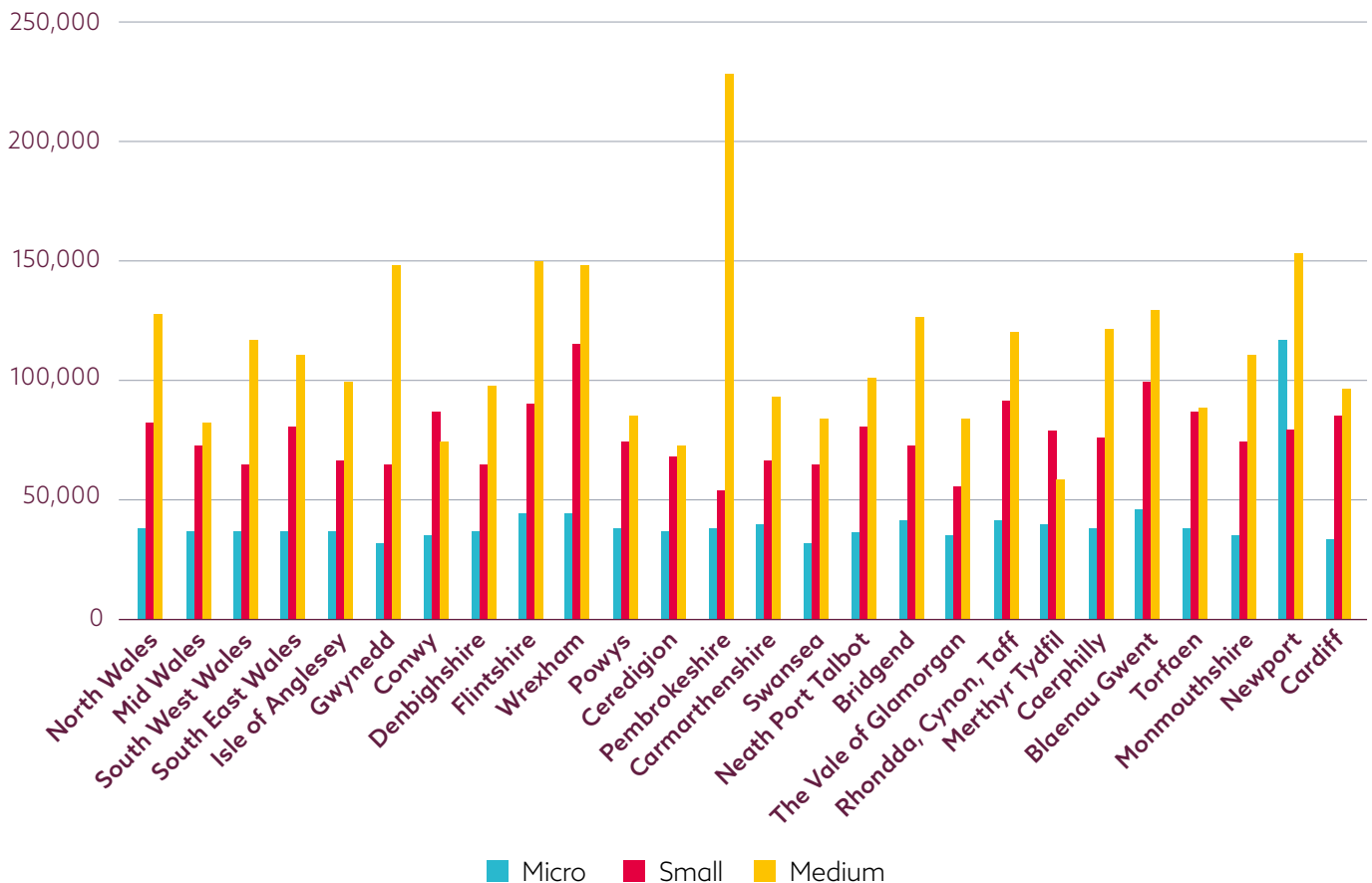
Medium-sized enterprises' population increased in all the sub-regions of Wales apart from Mid Wales between 2013 and 2018. However, their share in enterprise count declined in all the Welsh sub-regions from 2013 to 2018. The medium-sized firms' contribution to regional employment was above 10% in all the regions, apart from Mid Wales in 2018 (9%). The contribution of medium-sized firms to regional turnover is below 20% in all the regions, with North Wales recording the highest shares in both 2013 (15% of regional turnover) and 2018 (around 16.5% of regional turnover). The dominance of large company turnover in total turnover is evident in all the Welsh regions.

Productivity levels (defined here as turnover per employee)²⁸ differ substantially by size band as was revealed in section 4.1 of this report. However the data in Figure 6 also reveals differences across Welsh regions. In general, productivity increases with firm size. Medium-sized enterprises tend to be the most productive SMEs in all the Welsh regions and unitary authority areas (exceptions include Conwy and Merthyr Tydfil).

²⁸ Differences in the rates of part-time employment by size band between Wales and the UK may have some influence on these figures, see also footnote 25.

4.2 Firm productivity by employment size class across Wales

Figure 6.
Productivity levels – Turnover per employee £, 2018.



Source: Derived from Stats Wales (2019) <https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/Businesses/Business-Structure/Headline-Data/enterprises-by-sizeband-area-year>

Medium-sized firms in Pembrokeshire were the most productive SMEs in Wales with £229,000 turnover per employee in 2018. These businesses would include a number of relatively capital-intensive firms in the energy and specialised construction engineering sector. Micro companies in Swansea had the lowest productivity rates per employee at just over £31,000. It is expected that small sample sizes play some part in these results with individual firms in specific industries having a marked effect on the figures. Micro firms were most productive in Newport and

small companies were most productive in Wrexham. In Merthyr and Conwy small businesses were the most productive firms.

In terms of regions, medium-sized and small companies were the most productive in North Wales, while micro firms has the highest productivity in South East Wales. For SMEs as a group, the most productive firms were located in South East Wales, and the least productive in Mid Wales. At the unitary authority level, Ceredigion recorded the lowest micro business turnover per employee, and Newport the highest.

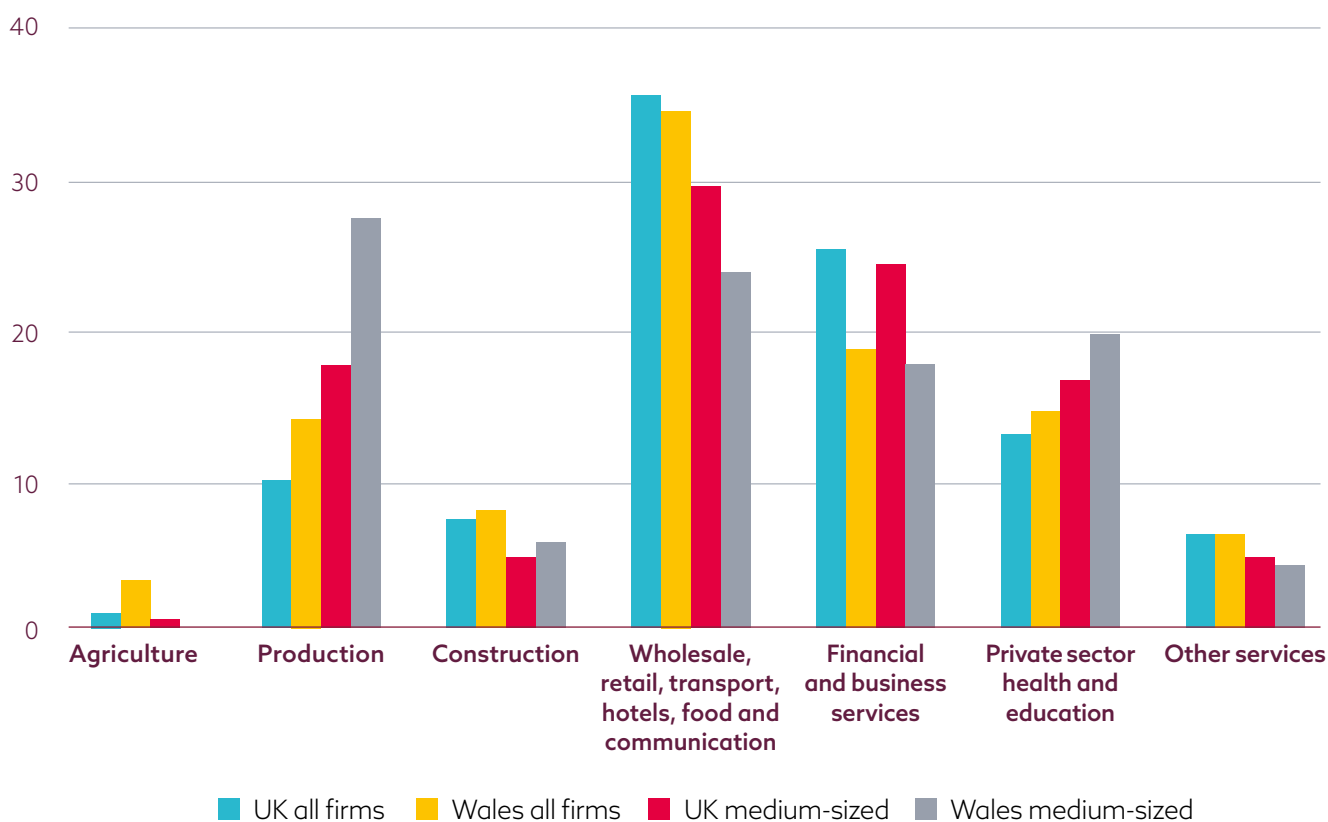
4.3. Industry distribution and productivity

Medium-sized firms in Wales have the highest employment shares in trade, accommodation and production sectors. Compared with the employment distribution of medium-sized firms in the UK, Wales has a relatively higher share in production sectors, and a lower share in financial and business services.

The high relative shares of Welsh medium-sized firms in production may partly explain the high output per employee estimates of medium-sized firms in Wales discussed earlier in this section. The production sector has the highest share of employment for medium-sized firms in Wales, much higher than the UK average (Figure 7). By contrast, medium-sized enterprises in Wales record a lower share in total employment in trade and accommodation than their UK counterparts.

Figure 7.

Employment share by industry and whether all businesses or medium-sized - Wales and UK (%), 2018.



Source: Derived from Stats Wales (2019) <https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/Businesses/Business-Structure/Headline-Data/enterprises-by-industry-sic2007-sizeband-area>

4.3. Industry distribution and productivity

Table 9 shows that the most productive industry for all companies in the UK in all the size bands is wholesale, retail, transport etc., but this is a broad sector in which productivity levels vary considerably. Moreover, the conclusions here would be very different if gross value-added per employee was computed as retail and wholesale will have large sales but varied margins. The largest gap between Wales and UK firms in this sector is for small firms, where productivity is around 52% of the UK average (this compares to 65% of the UK average for micro firms and 66% for medium-sized firms).

Production is the sector with the highest productivity in medium-sized firms in Wales. The most productive small firms in Wales are in the construction sector. The only companies in Wales

that are more productive than their counterparts in the UK are the micro and medium-sized firms in production. Table 9 confirms that in most sectors turnover per employee increases with firm size in Wales, and typically productivity on this measure shows Welsh medium-sized firms over twice as productive as their micro-firm counterparts. Also differences in productivity are particularly marked between small and medium-sized firms in Wales in sectors such as Production and Wholesale etc. Table 9 also confirms that in comparing medium firm activity and performance between areas it will be important to give due consideration to industrial structure characteristics; so while turnover per employee tends to increase with firms employment size, it varies considerably across industries in the same employment size class.

Table 9. Turnover per employee by selected industry and firm size, Wales and UK, 2018²⁹.



	Agriculture	Construction	Other services	Private sector health and education	Production	Wholesale, retail, transport, hotels, food and communication
Turnover/employee micro firms						
UK	85,189	73,726	25,378	18,831	74,960	97,913
Wales	48,791	47,013	18,163	17,491	99,862	63,819
Turnover/employee small firms						
UK	111,773	177,644	58,961	51,782	127,963	194,077
Wales	90,074	138,545	35,956	49,901	125,100	100,304
Turnover/employee medium-sized firms						
UK	94,929	218,416	75,940	45,197	173,659	268,313
Wales	-	158,468	51,812	44,056	183,202	176,627

Source: Stats Wales (2019) as Figure 7

²⁹ Turnover data is not available for all industries by size band in Wales.

4.4. Medium-sized firm turnover growth

Insights on firm dynamics can be gained from an analysis of growth within the medium-sized group of firms in Wales. Using the FAME database, firms can be tracked in terms of turnover growth for varying time periods (up to 10 years). This analysis reveals that growth is only achieved by specific enterprises. For example, relatively few Welsh medium-sized firms achieved significant three-year growth of their turnover.

Figure 8 shows the three-year growth index of turnover for 509 Welsh medium-sized firms³⁰. Here, if a firm has an index value of 100, this shows there to be no growth in turnover over the period. Figures above 100 show turnover growth and those below 100 indicate a fall in turnover. For the majority of companies shown in Figure 8, turnover growth was less than 50%, with a number of companies experiencing a fall in turnover. An interesting research question here is the extent to which this reveals internal or external firm constraints.

509

three-year growth index of turnover for Welsh medium-sized firms

58

firms out of the 509 companies experienced turnover growth of more than 50%

There were 58 firms out of the 509 companies which experienced turnover growth of more than 50% over the three year period. For the last available year of data, employment in these 58 firms ranged from 50-221 (average 107). There were no obvious differentiating characteristics for these faster growing firms from the rest of the sample. For example, in terms of incorporation date, around half the firms were founded before 2001, and in terms of industry sector, the firms represent 30 different industry sectors (as defined by 2 digit SIC 2007 code). However, of the 58 faster growing firms, an analysis of their employment alone reveals that close to 25% would have been defined as small firms (i.e. employment up to 49 people) at the start of the 3 year period but had grown to an employment level of 50 or more at the end of the period.

It is important to note that this sample includes all firms on the FAME database who were active and where data was available for the whole period of analysis. There may be other medium-sized firms who were taken over, or failed during the period who would not be included within the group of 509 enterprises shown in Figure 8. This analysis is therefore only partial, but provides some indication of medium-sized firm activity. In addition, this data is in current prices so takes no account of price changes. Real terms turnover growth is therefore below that shown in Figure 8.

³⁰ Data for all active companies with 50-249 employees during the last available year. Not all current active firms had data for 3 years. To be included in the sample, firms will be medium-sized according to data for the last available year. Some firms may not have been medium-sized at the start of the period analysed.

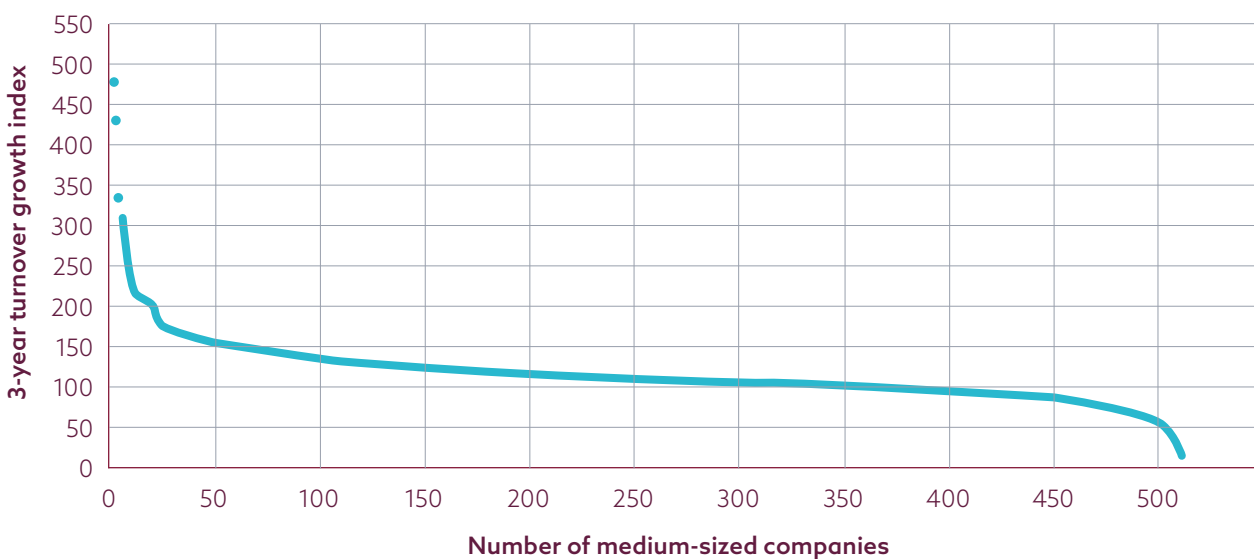
4.4. Medium-sized firm turnover growth

The same analysis for a 10-year period identifies only 230 firms which have data for the full period, although for these firms, almost half have grown by more than 50%.

However, as this data is in current prices, and over a longer period more caution is needed in drawing firm conclusions from this analysis.

Figure 8.

Three-year turnover growth index of Welsh medium-sized firms.



Source: FAME database analysis, July 2019

4.5. Conclusion

The distribution of SMEs in the Welsh economy largely follows the distribution of overall economic activity. In terms of geography, South East Wales had the highest density in medium-sized firms, with medium-sized enterprises' population increasing recently in all the sub-regions of Wales apart from Mid Wales.

The analysis of firm performance provides some insights into the differences between Welsh and UK firms. This shows that medium-sized firms are much more likely to be characterised by higher productivity than their small or micro firm counterparts across the UK and in Wales. However, the section reveals

that while productivity varies by employment size class, there is also variation in the same industry within the same size class.

An analysis of business growth (measured by turnover growth) within the medium-sized group of firms in Wales shows that while a small number of firms experienced strong growth, the majority of firms experienced either a decline in turnover growth or very slow growth over the most recent three-year period. A ten-year analysis shows a much smaller population of firms which have been active and have data available for the full period.

Previous sections show that the share of medium-sized firm in the Welsh enterprise count has changed little in recent years, with the increase in the firm stock largely a result of increases in micro firms.

This might suggest that Wales does not have strong rates of firm transition to medium-sized enterprises. This section seeks to explain some of the factors that may influence business evolution and business dynamism in Wales.

5.1. Business birth rates

Business birth rates and death rates link through to the dynamism of the business population. The business birth rate in Wales has recently (2017) been higher than in the other devolved areas, and also higher than the UK average.³¹ The business birth rate (births as a proportion of active enterprises) in Wales was 13.7%, in Scotland 11.9%, and Northern Ireland 11.3%, in 2017.³² These birth rates need to be considered in the context of the survival prospects of companies. Survival prospects vary though time, and were particularly affected by the 2007/08 global financial crisis.

For example, the one-year survival rate of firms in Wales was 94.5% on average between 2002 and 2007, falling to 91.3% in 2008-2014. The average three-year survival rate was 64.2% in the first period, declining to 58.9% on average from 2008 to 2012 (FSB, 2017).³³ More recent data show that three-year survival rates for the companies that started in 2014 in Wales (60%) are similar to those for England, Scotland and Northern Ireland.³⁴

13.7%

Wales's business birth rate in 2017

11.9%

Scotland's business birth rate in 2017

11.3%

Northern Ireland's business birth rate in 2017

³¹ See <https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/Businesses/Business-Demography/businessbirthsrates-by-area-year>

³² These are provisional figures, and show an increase in the business birth rate for Wales from 12.3% in 2016 to 13.7% in 2017. The next update to these figures will be published in November 2019.

³³ FSB (2017). Wales' missing middle. Available from: https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb_missing_middle_eng.pdf?sfvrsn=0

³⁴ Business Demography, Office for National Statistics. Available from: <https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/datasets/businessdemographyreferencetable>

5.2. Low SME growth ambitions

The connections between growth ambitions of SME leaders and underlying business growth prospects have been extensively researched in the UK (see BEIS 2016 for recent research).³⁵

The *SME Finance Monitor 2018* revealed that the lowest rate of SMEs planning to grow in the UK was recorded in Wales on average through the period 2013-2018.³⁶ This may indicate the low growth ambitions of many Welsh SME owners, with this one factor determining the number of micro and small enterprises that evolve into medium-sized firms. Moreover, *SME Finance Monitor 2018* indicates that only 35% of the surveyed SMEs in Wales recorded growth in the previous 12 months.

Data from the annual *Small Business Equity Tracker*, published by the British Business Bank, indicate that Wales' share of total UK SMEs has remained stable at around 4% for much of the period after 2010. Wales' share of UK high growth companies has only slightly increased, growing from 3% in 2014 to 4% in 2016 and 2017.³⁷ Wales recorded the second lowest share of scale-ups among the UK regions after Scotland³⁸ and the third lowest-share of step-ups³⁹ after Scotland and East Midlands. So relatively low growth ambitions may be associated with the evolution of the private business stock. While business birth rates may be comparatively strong in Wales (see 5.1), this strength may in part be counteracted by lower growth ambition, and with such factors working together to affect regional productivity levels.

5.3. International trading

Welsh SMEs have much lower export intensity than SMEs in the other devolved administrations, as shown in the EIW Export Finance report.⁴⁰ Results from the ONS Longitudinal Small Business Survey 2018 revealed that in 2018, just 13% of Welsh SMEs exported goods

and/or services, the lowest proportion in the UK.⁴¹ Engaging with international trade could significantly boost the prospects of a firm, due to scale economies, knowledge spill overs and technology exchange, and increase the wages of the employees.

³⁵ See BEIS (2016) Business growth ambitions amongst SME leaders - changes over time and links to growth. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/552513/beis-16-17-growth-ambition-report-2016.pdf

³⁶ BVA BDRC (2019) SME Finance Monitor 2018. Available from: http://www.bva-bdrc.com/wp-content/uploads/2019/06/BVABDRC_SME_Finance_Monitor_Annual_Report_2018_F.pdf

³⁷ British Business Bank (2019). Small Business Equity Tracker. Available from: <https://www.british-business-bank.co.uk/wp-content/uploads/2019/06/Small-Business-Equity-Tracker-2019.pdf>

³⁸ According to the Enterprise Research Centre scale-ups are start-ups with revenue of below £0.5m that grow to over £1m in revenues after 3 years.

³⁹ According to the Enterprise Research Centre step-ups are firms that have increased their turnover from the range between £1m and 2m to at least £3m over a three-year period.

⁴⁰ EIW (2019) Export Finance in Wales. Available from: https://developmentbank.wales/sites/default/files/2019-02/English_Bespoke%20Report_FINAL_25%20Feb2019.pdf

⁴¹ BEIS (2019). Longitudinal Small Business Survey: SME employers (businesses with 1-249 employees) - UK 2018. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/803645/LSBS_2018_employers.pdf

5.4. Government intervention

Government interventions have the potential to support company growth and to stimulate a more dynamic firm size evolution. Indeed Welsh SMEs that have received government assistance and support typically show better survival prospects than firms which have not received assistance.⁴²

This could simply be related to the potential for more ambitious and focused SMEs to seek support. However, around 70% of respondents to an FSB survey in Wales highlighted the need for greater support, especially in the areas of marketing and financial advice to develop businesses (FSB Wales 2013)⁴³ although it is accepted that this is now a dated survey and was based on self-reported information.

However, even where greater levels of support become available, there is a tangential issue of reported low SME awareness of government support schemes. Export supports are a good case in point. For example, according to the recent EIW Export Finance report, 76% of surveyed Welsh SMEs considering exporting and firms that indirectly exported through sales to UK firms were not aware of export finance support provided by government bodies.⁴⁴ Moreover, the proportion of Welsh enterprises between 2014-15 to 2016-17 that accessed either the Enterprise Investment Scheme or the Seed Enterprise Investment Scheme, both UK government schemes, was just 1.9% on average.⁴⁵

Government support and interventions in Wales impact the evolution of the private business stock. A good example is current Business Wales support under the Accelerated Growth Programme to target resources on the most ambitious and fast growth prospect firms. This type of programme has had success (for example the Business Wales Accelerated Growth Programme has led to the creation of new jobs and exports in the period 2015-2019).

Undoubtedly, due to their success, selected firms supported by intervention will become potential targets for external takeovers, and this is not necessarily a negative outcome for regional economic development. The challenge would seem to be ensuring that where firms wish to grow and remain locally controlled, that intervention supports this, perhaps in terms of facilitating local succession. For example in this respect the Development Bank for Wales has a Wales Management Succession Fund to assist such progression. At the same time care is needed in monitoring the potential for negative feedback consequences from interventions. For example might national loan guarantee schemes provide incentives, including capital gains and tax concessions, for founders to sell out at early stages? Moreover, might support through government supported business angel networks lead to external equity in fast growth SMEs that seeks early realisation of the investment i.e. impatient capital?

⁴² See for example prior evaluations of Business Wales interventions, Final Evaluation of the Customer Engagement and New Business Start Up Support Projects. Available at <https://gov.wales/sites/default/files/statistics-and-research/2019-07/161005-evaluation-customer-engagement-business-start-up-projects-en.pdf>

⁴³ FSB Wales (2013). Small Businesses in Priority Sectors. Available from: <https://www.fsb.org.uk/docs/default-source/Publications/policy/rpu/wales/images/cu-fsbw-small-businesses-in-priority-sectors.pdf?sfvrsn=1>

⁴⁴ EIW (2019) Export Finance in Wales. Available from: https://developmentbank.wales/sites/default/files/2019-02/English_Bespoke%20Report_FINAL_25%20Feb2019.pdf

⁴⁵ HMRC (2018) Enterprise Investment Scheme Seed Enterprise Investment Scheme and Social Investment Tax Relief. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/710986/May_2018_Commentary_EIS_SEIS_SITR_National_Statistics.pdf. British Business Bank (2017) The benefits of diverse smaller business finance markets. Available at: <https://british-business-bank.co.uk/wp-content/uploads/2017/09/291-Diversity-Report-2017-LR.pdf>

5.5. Funding issues

FSB Wales reported that in 2012, 30% of surveyed SME owners in Wales cited access to finance as a key developmental problem.

According to the ONS Longitudinal Small Business Survey 2017, just 6% of Welsh SME owners used alternative finance⁴⁶, compared to 11% in Scotland, 10% in England, and 8% in Northern Ireland. However, according to the Small Business Finance Markets Report 2018/19, the volume of lending to SMEs in Wales was 8% of the UK loans provided in 2018, with the Welsh share of UK SMEs being 4%.⁴⁷

Access to external finance is related to issues such as credit risk; credit risk is a strong determinant of business survival prospects. Figure 9 provides risk information for over 60,000 SMEs in Wales. The proportion of SMEs in Wales falling into the High risk and Caution categories is slightly above the UK average. Moreover, Economic Intelligence Wales quarterly reports have indicated that the rate of SMEs in the High-risk group has increased since mid-2018.

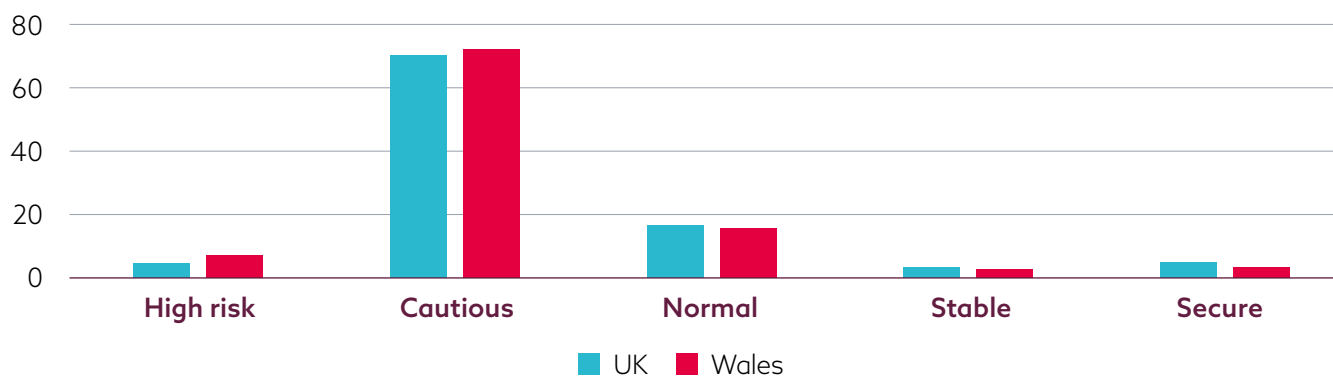
Welsh SMEs use of finance

According to the *SME Finance Monitor 2018*, the proportion of surveyed Welsh SMEs using any type of external finance was 44% (UK, 36%), the highest rate in the SME Finance Monitor surveys since 2013. Around 43% of Welsh SMEs surveyed were permanent non-borrowers (UK, 48%). In the last 12 months 84% of surveyed Welsh SMEs reported they were happy non-seekers who had not sought, or wanted to seek, finance (UK, 83%).

In summary, the funding gaps of Welsh SMEs and their low appetite for finance (linking with their low growth ambitions, and high rates of permanent non-borrowing)⁴⁸ are not ideal conditions for a dynamic business population. The complex interlinkage between SME credit scores, low growth ambition, and access to finance in Wales is an issue that requires greater levels of future research.

Figure 9.

SME credit risk: estimated proportion of SMEs in each credit class.



Source: Derived from FAME, 2019

⁴⁶ Alternative finance is that originating from any other sources apart from the banks, the state, and internal finance.

⁴⁷ British Business Bank (2019) Small Business Finance Markets 2018/19. Available from: https://www.british-business-bank.co.uk/wp-content/uploads/2019/02/British_Business_Bank_Small-Business-Finance-Report-2019_v3.pdf

⁴⁸ BVA BDRC (2019) SME Finance Monitor 2018. Available from: http://www.bva-bdrc.com/wp-content/uploads/2019/06/BVABDRC_SME_Finance_Monitor_Annual_Report_2018_F.pdf

5.6. Structural issues of the Welsh economy

The distribution and evolution of business size in Wales are affected by more general industry structure and function issues.

Some industries are always growing faster than others and with Wales known to have higher employment specialisation in sectors that are growing relatively slowly at an international level. Wales' GVA hysteresis - Welsh GVA per head has been around the 73% of the national average, falling from 75% in 1998 to 73% in 2017⁴⁹ - is partly a function of its distribution of activity between different industries. In addition to this, there is also an issue of the control locus of firms.

Wales is a regional economy where many of its business head offices are located outside the region. This is evident from the different insights into the medium-sized firm stock from estimates that do or do not take account of firms where there is significant regional activity but with no registered regional office (see section 3.1). Some research has argued that employment is relatively more stable in foreign subsidiaries in Wales.⁵⁰ The relative stability of regional activity in firms with or without registered offices in Wales is an issue which merits further research.

73%

Welsh national average of GVA per head

-2%

decrease in Welsh national average of Gross Value Added per head since 1998

⁴⁹ <https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/Regional-Accounts/Gross-Value-Added-GDP/gvaperhead-by-area-year>

⁵⁰ See McNabb R. and Munday, M. The stability of the foreign manufacturing sector: Evidence and analysis for Wales 1966-2003, *European Urban and Regional Studies* 24.1, 2017, p50-68

5.7. Welsh economic history

Another influence on the distribution of firm sizes and their evolution is economic history. For example, regions with a history of large industry domination find it more difficult to provide a bedrock for fast growth small firms.

The economic history of Wales has impacted on the business structure in the region. In the post-industrial revolution era, the Welsh economy was based on large corporations active in extraction and heavy manufacturing. Regions with a history of large companies dominating may find it more difficult to provide the ground for fast growth small firms.

In addition, the contraction of the mining and steel industries, and the capital flight to low cost countries have had further consequences for Wales, becoming characterised as an old industrial region, similar to other cases across the UK and Europe, including North East England, Walloon in Belgium, and Ruhr in Germany.⁵¹ Relatively higher historical dependencies on fewer large industries can link through to current trends in business birth rates, as well as levels of explicit entrepreneurship. Consequently the business, development and policy choices of the past have a part to play in the current evolution of the business stock.

5.8. Conclusion

This section has explored some potential factors that may explain low levels of business evolution and dynamism in Wales.

Included in the suggested factors are low SME growth ambitions in Wales. This factor is particularly important, as this is linked to many other factors such as low rates of international trading, and funding issues (from the supply and demand side). Other

factors identified include the nature and awareness of government interventions, structural and historical factors. It is therefore difficult to separate these factors, with the explanations for low rates of business evolution relating to a complex mix of factors which are both internal and external to each firm and industry. The final section of this report outlines the key conclusions and identifies issues for further research.

⁵¹ Birch, K., MacKinnon, D. and Cumbers, A. (2010). Old Industrial Regions in Europe: A Comparative Assessment of Economic Performance. *Regional Studies*, 44:1, 35-53.

The report has revealed that Wales has a similar share of medium-sized firm, in terms of enterprise count, and higher share, in terms of contribution to employment and turnover, compared to the UK average. Therefore, within a UK context, there is no missing middle if this is considered in terms of the proportion of medium-sized firms in the business count in Wales. Indeed medium-sized firms make a relatively important contribution to the regional economy.

This report also confirms that there is no unique or ideal business structure. Critically here definitions of dividing lines between micro, small, medium and large firms are heavily contested, with care needed in interventions which may prioritise one business size class over another. In the contemporary Welsh economy, it is important for interventions to encourage productivity growth and innovation irrespective of firm size. However, it is critical for interventions to support small firm progression to medium-sized firms, and to encourage progression among medium-sized firms. The analysis in this report indicates the relatively small numbers of Welsh medium-sized firms and establishments that report strong growth over a 4-10 year period. While there is inevitable interest in the fastest growth firms, attention is also needed to explain why the majority of medium-sized firms in Wales grow more slowly and the balance between internal firm and external market and environment factors in explaining slower growth.

The report makes no conclusions on whether Wales would benefit from more or fewer medium-sized firms as a proportion of the private business stock. While in the UK as a whole, medium-sized firms lag their counterparts in several EU countries, in terms of their share in enterprise count, employment, and turnover, there is little in terms of concrete connection between differences in the contributions of business by size class and regional productivity, and this connection would be difficult to examine empirically.

However, the report suggests that smaller firms in Wales face challenges in moving to medium-sized enterprises. Growth in the number and share of companies across the medium-sized bands in Wales has been relatively weak compared to growth in other size classes. The report cites a series of issues influencing such progression.

The report reveals that issues of definition of medium-sized firms make analysis problematic. For example, small firms having the characteristics of medium-sized firms in terms of reach and output, but not in employment. Indeed, the common conclusion made in respect of this issue is that what is a small or medium-sized firm varies according to the reference industry, and even within industries increases in outsourcing also hinder consistent analysis. With those issues noted, this report suggests that there could be important differences according to the control locus of medium-sized firms in Wales.

Differences in the economic characteristics of medium-sized firms controlled from within Wales as opposed to those with activity in Wales but being headquartered elsewhere, could be important. An underlying hypothesis here is that locally controlled firms could use a wider range of higher value functions and provide more occupational depth than firms where effective decision making is placed external to the region. For example, a branch of a larger manufacturing organisation may not provide opportunities for a wide range of skills. Here it might be the case that higher value functions are placed elsewhere in the corporate structure. Future research in Wales should focus on issues of ownership and control, and the consequences for the local economy, particularly in terms of skills development, finance demands, and local purchasing behaviour. This would seem to be particularly important as interest grows in the concept of the foundational economy.

Related to the above point, recent history is littered with cases where successful Welsh firms reach a threshold and then are bought by external firms (for example, Howies, Rachel's Dairy). This is not necessarily a bad thing in a market economy, albeit with rather fewer cases of Welsh firms going on to become multinationals in their own right. However, understanding the structure of firm ownership and succession is important to the understanding of business evolution and demography in Wales, and the related implications for economic development. Key SME research questions are the dynamics of firm sizes, for example, how many medium-sized firms succeed to become large firms, and what happens to business growth prospects after firms get taken over by external firms? These issues will be explored in an EIW report during 2020.

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