

Taking the **M** out of
SME

Seven factors making M-businesses the
powerhouse of Britain's economy

A Joint Research Report by the Institute of Chartered Accountants
in England & Wales and BDO Stoy Hayward

June 2005

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M-businesses are the powerhouse of the UK's economy, a sector creating wealth out of all proportion to its size. Yet near invisibility starves it not only of recognition but of properly targeted assistance: just 7% of M-businesses regard public sector aid as significantly helpful. The problem stems from a failure to identify and appreciate a set of highly distinctive – and success driving – characteristics.

M-Businesses: A Culture of Success

New Institute of Chartered Accountants-BDO Stoy Hayward research focused on enterprises with turnovers between £10 million and £250 million: they total only 6% of UK companies but employ 30% of the nation's business workforce and generate almost 20% of corporate profits.¹

But the real differentiator from small businesses isn't scale, it's a different frame of mind. M-business success is driven by disciplined creativity – a distinctive blend of professionalism and an enabling culture in the service of long-term growth.

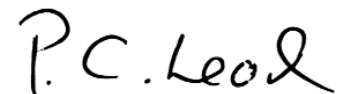
M-businesses need to be treated very differently from the small and micro companies with which they are bracketed. The term 'Small and Medium sized Enterprise' has become a straitjacket for public policy. It's time to take the 'M' out of SME.

Understanding the sector is vital to economic development. The more we know about these companies – their values, their culture, their behaviour – the easier it will be for their smaller counterparts to emulate them.

This report identifies seven key M-business characteristics. It will help change the way they are seen; we hope it will provoke an urgent debate about the way they are treated.



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¹ Figures are derived from an Institute of Chartered Accountants / BDO Stoy Hayward analysis of independently owned UK companies filing accounts with Companies House.

What Makes M-Businesses Tick?

The survey outlined in this paper found that 80% of businesses with a turnover of £10m-£250m identified themselves as 'medium sized'. But focusing on turnover doesn't take us far; a more important question for policy makers, advisers and financiers is what makes the sector tick.

Detailed research conducted by the Institute of Chartered Accountants and BDO Stoy Hayward in 2004/2005 set out to identify the characteristics and behaviours of M-businesses that distinguish them from smaller ones. A significant number of the Institute's members work in medium companies, which also comprise much of BDO Stoy Hayward's client base.

The research consisted of interviews with 15 M-business CEOs in order to identify issues (August 2004); a quantitative research survey of 185 medium and small businesses in order to compare the two sectors (September- October 2004); 11 regional forums across the UK – involving CEOs, FDs plus representatives from regional development agencies, private equity providers and locally-based mid-tier accountancy firms – in order to validate the findings (October 2004-March 2005).

The project highlights seven key characteristics that set M-businesses apart from small enterprises:

- 1 They are run by professional management teams** with a range of specialist skills. Their CEOs lead rather than micro-manage.
- 2 They develop enabling cultures** characterised by employee development and involvement. People quality is their real differentiator.
- 3 They create effective systems.** Structures, processes and controls make for better decision making.
- 4 They have longer time horizons.** Anticipating market change and building for the long term are central preoccupations.
- 5 They value outside advice** from non-executive directors, professionals and suppliers.
- 6 They distribute equity** beyond their founders, accepting the trade-off between more finance and wider ownership.
- 7 They diversify their customer base,** being twice as likely as small enterprises to have less than 20% of their annual turnover accounted for by their top five customers.

The following pages discuss the findings in more detail.

1

“As CEO I’m now more like a conductor trying to make sure everyone’s playing at the right time and the right speed.”

“I’ve seen situations where you only had a semi professional person and come to a full stop. You need someone with the proper qualification in order to progress beyond a certain size.”

A Professional Management Team

Specialisation. Vital business functions are run by individuals with specialist skills and experience. There’s far less control by founders and the CEO serves as leader rather than micro-manager. Only 52% of small businesses are ‘very confident’ that they have the skills to take their company forward over the next five years, compared with 81% of M-businesses.

Financial Skills. M-businesses usually recruit chartered accountants as finance directors. 60% have a head of finance with that qualification, compared with only 18% of small enterprises.

Key to graphs



Small businesses

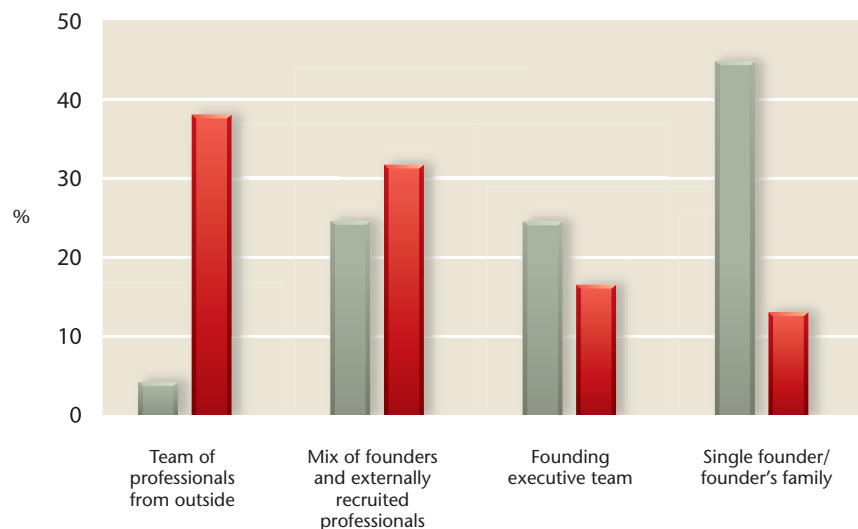


M-businesses

Chart 1

More Professional Management

Which of the following most closely describes who runs your company?



An Enabling Culture

Human Capital. M-businesses have an ingrained belief in staff development and retention, viewing it as the single most important factor in their success over the previous five years. Small businesses tend to place more importance on shorter term competitive advantages such as technology.

Empowerment. M-business culture is more likely to involve increased employee responsibility supported by knowledge sharing. 63% of M-based CEOs consider their internal company culture a significant success factor.

Branding. 54% of M-businesses believe the company's brand is a key to business achievement.

“A successful company differentiates itself through a significantly differentiated product and/or the quality of its people. Significantly differentiated products are rare these days!”

“When you move from telling people what to do to asking individual employees to contribute towards decision making, the value of the brand starts coming through. It creates an identity which people can both stand behind and move forward.”

3

Creating Effective Systems and Structures

“A small company becomes a medium company when it starts putting structures and processes in place.”

M-businesses are far more likely to operate with well-defined structures and processes – targets, budgets, business plans, regular board meetings and financial controls.

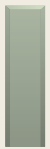
79% of M-businesses see themselves as being run formally (holding regular Board meetings with agendas, agreeing annual budgets and managing performance against them), compared with only 31% of their smaller counterparts.

Chart 2

Defined Structures and Processes

How formally or informally is your company run?

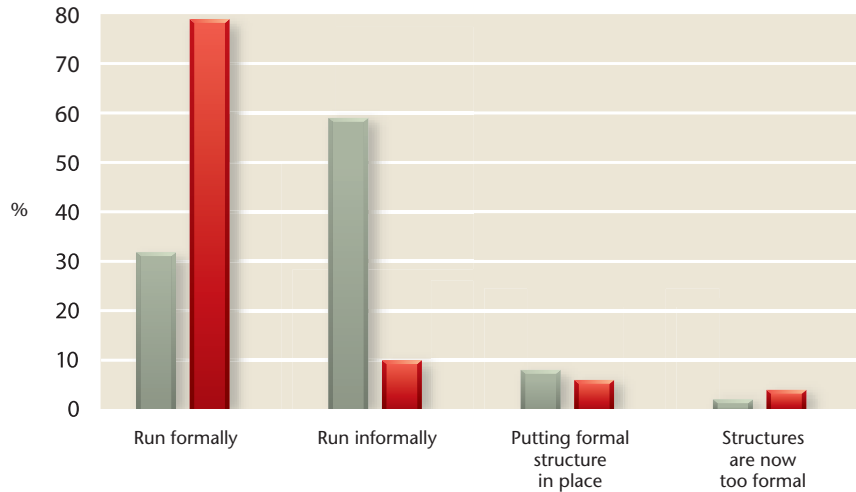
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Longer Time Horizons

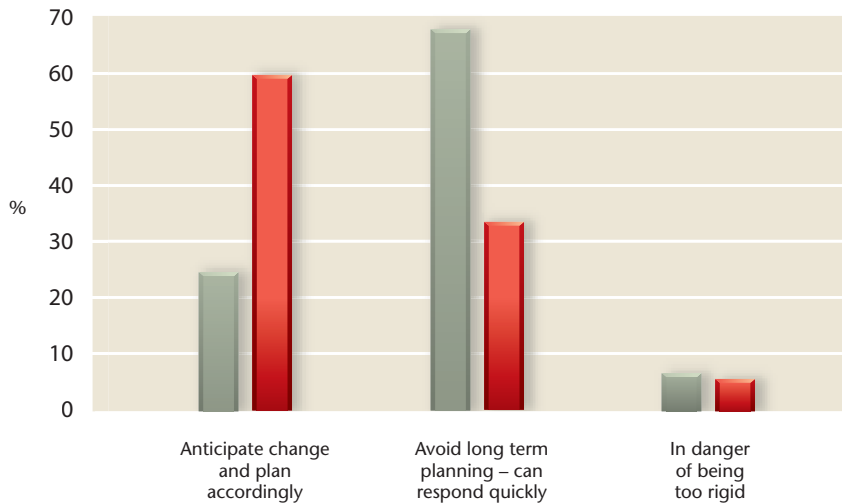
M-business management is more likely to think and plan for the long term. 60% anticipate market change and plan accordingly, compared with only 25% of small companies.

M-businesses are also more likely to be building for the long term; 75% of them have this goal compared with 52% from the smaller category.

Chart 3

Anticipating Change

Regarding changing market conditions, which of the following describes your company?



“Decisions are now made on the basis of facts. When we were smaller our business decisions were made on opinions, hearsay and gut instinct.”

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M-businesses

“Non Execs add huge value. It may be brand new territory for us but they’ve been there and learnt to guide while leaving the decision to you.”

“When people have got things spectacularly wrong you often find they’ve got their advice from their business friends.”

“Either what is offered is not relevant or there aren’t sufficient portals into the agencies for medium-sized businesses.”

Valuing Outside Advice

Non-Executives. Not only are M-businesses more likely to have appointed non-executive directors, they are far more likely to appreciate the experience and insights that they bring. 41% value this ‘sounding board’ role, compared to 28% of small enterprises.

Professionals. A greater reliance on professional advice – especially from accountants and lawyers – is an M-business hallmark. 15% of small enterprises consider friends and family an important source of business advice but only 2% of M-businesses agree.

Suppliers are seen as an important source of market advice by 57% of M-businesses compared to 38% in the small enterprise sector. The supplier is often a key source of product and competitor information.

...but Not Government. While 28% of small businesses see advice from business support agencies such as RDAs, Business Links, or enterprise agencies as important, just 7% of M-businesses feel the same regard.

Distributing Equity

An M-business is more likely to have distributed share capital beyond the small circle of its founders. Though this is usually due to a need for additional finance re-distribution also requires a willingness to cede total control of the company. In some cases management has been given equity for the purposes of retention or incentivisation, especially where the founders are planning their exit. 82% of small organisations are owned by the founding team or family, compared with 56% of M-businesses.

“As companies move from being a small company to a medium one the owners have to look beyond their own personal ambitions and consider the team that is driving the growth.”

7

Diversifying the Customer Base

“It goes back to having more process in the business. A larger company identifies the risk of having a dominant customer base and the need to diversify.”

Growing M-businesses continually diversify their customer base and do so to a far greater extent than their small counterparts. 46% of M-businesses have less than a fifth of their annual turnover accounted for by their top five customers, compared with 23% of small enterprises.

Chart 4
Diversifying the Client Base

What percentage of total turnover do your 5 largest clients account for?

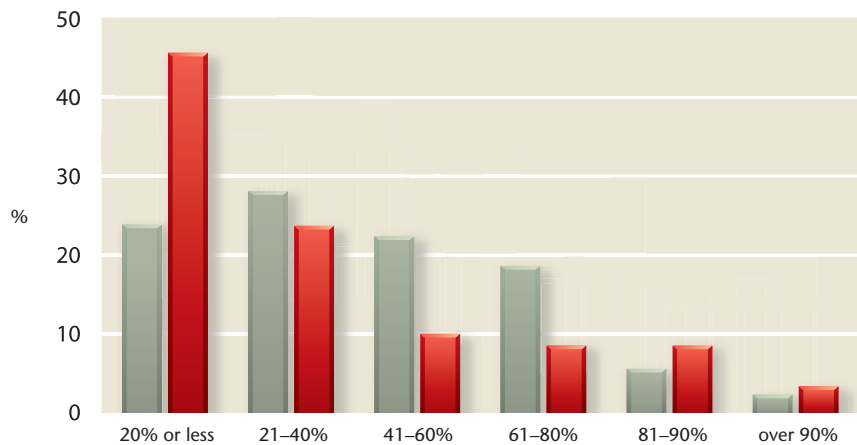
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Small businesses



M-businesses



M-Businesses

Speak to Government

Participants in the eleven regional forums organised to discuss the research raised a number of issues for public policy makers. Here are some of them.

Champion M-business

- “ I would like more recognition of medium businesses as a group and assistance on how to take us forward, how to develop strategies, how to grow. ”
- “ Government’s got to come to terms with the medium size company because if you look at most supply chains they’re at the node of so many of them. ”

Recalibrate Regulation

- “ Re-direct effort away from business support schemes that don’t seem to work terribly well and use agencies for regulatory compliance instead. If somebody could come in and do a Health & Safety audit, or look at our environmental health policies it would save us from diverting staff within the company. ”
- “ Regulation doesn’t recognise enough graduation. Government is too ready to apply rules for big companies to the middle group. ”

Simplify Employee Share Schemes

- “ If the Government want to incentivise people into share ownership, they should review the complexity of share schemes. We had a scheme to motivate staff which was quite simple to run. It’s a now a nightmare to administer. ”

Provide a Better Framework for Expansion Capital

- “ The availability of finance for medium businesses is a problem – there’s no 20% money out there. There’s secured bank lending if you’ve got the assets and there’s venture capital at 40%; but there’s no money for intangible investment at 15% or 20% returns. ”
- “ The problem with funding above £250k and less than £5m is that there are big costs for the borrower and not enough fees for the lender. That’s why there’s a distinct shortage of funds in that range. ”

Encourage More Use of Non-Executive Directors

- “ Medium businesses are part of the backbone of the business economy. We need to provide more support so why not a non-exec tax credit? ”

About the Project Partners



The Institute of Chartered Accountants in England & Wales

The Institute of Chartered Accountants is the largest professional accountancy body in Europe, with more than 126,000 members running or advising businesses in almost every sector.

With an overwhelming majority of medium-sized businesses as well as FTSE listed companies having a member of the Institute as finance director, as well as professional services firms and general practitioners in every high street advising those businesses, the Institute has a unique perspective on the performance and needs of UK PLC and UK Ltd companies.

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BDO Stoy Hayward

BDO Stoy Hayward

BDO Stoy Hayward is a large accounting and business advisory firm specialising in advice to medium-sized companies. It operates out of sixteen UK business centres and a 600-office international network in 100 countries. BDO Stoy Hayward is the only accountancy firm in the Sunday Times 'Top 100 UK Companies to Work For'.

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