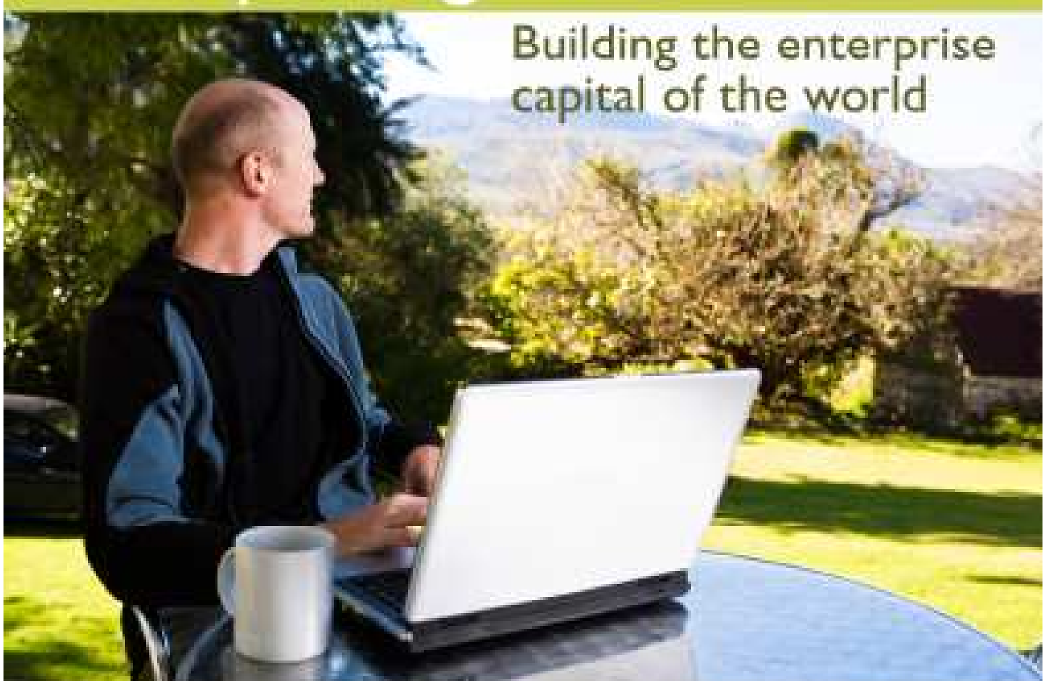
Enterprising Britain:

Building the enterprise capital of the world



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- There is a growth threshold – once companies reach a certain size, growth becomes much faster (our analysis shows that it takes on average 14 years for a company to reach a £5 million annual turnover and only 2 more years to hit £15 million)
- This struggle for growth can be explained by two factors: a mental barrier (business owners not aspiring to expand their businesses) and an environmental barrier (business owners finding it difficult to achieve growth)

Entrepreneurial culture

- Individuals in the UK are less inclined to start a business than in other G8 countries
- Across the EU including the UK, the goal of becoming self-employed is perceived as unrealistic –more so than in the US
- UK entrepreneurs have become more risk averse, particularly in terms of bankruptcy and personal assets
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- The public perception of entrepreneurship as a basis for wealth and job creation is much less favourable in the UK than other EU countries and in the US
- There is an insufficient spread of positive role models through the media, and UK entrepreneurs do not tend to identify with the few role models that are prominent. Instead most emphasise the importance of personal networks

Access to finance

- External sources of finance are crucial for fast growing companies, and a healthy venture capital industry does not only offer a source of funds, but provides an incentive for entrepreneurs to build high value firms
- Attempts by the government to provide access to finance are misdiagnosing the problem and turning profit-seekers into grant-seekers
- There is no shortage of financing available to UK entrepreneurs, however better coordination would improve the prospects of high growth businesses seeking support

- Business angels find it costly to participate in syndicates, and the amount of funding available to entrepreneurs could be increased if these costs were reduced

Human capital

- UK education is perceived as much less effective in helping students develop an entrepreneurial attitude, basic business skills, and entrepreneurial interest
- The UK is losing out in terms of competitiveness in relation to other G7 countries, with lower rates of productivity and a widely perceived shortage of skills
- Employers are finding it increasingly difficult to hire skilled staff due to poor standards of education and inadequate vocational or real life experience
- Only 25% of UK companies have achieved a product/service innovation, and even fewer companies (16%) have introduced innovations to business processes
- The number of patents has been slowly decreasing over the last 3 years and the UK is far behind other G7 countries
- The ability of small companies to preserve their intellectual property is a key characteristic of fast-growing companies but they experience significant barriers to protecting their IP
- Universities, though considered major sources of research and development, are among the last partners that enterprises would consider cooperating with for innovation; however they can have very positive effects on business growth and success

Regulation

- An economy conducive to entrepreneurship must enable profitable ventures to grow and unprofitable ones to relinquish their capital
- Red tape is frequently reported as the largest constraint to the growth of businesses - the total cost of the major regulations to business approved since 1998 totals £50 billion and is on the increase
- Time spent on complying with legislation has increased over the previous two years and this lost time is costly, particularly to smaller businesses
- The more employees a small business has, the larger the relative burden, but further growth becomes more cost effective beyond a certain threshold
- Business owners are increasingly dissatisfied with the volume, along with the complexity and rate of change of legislation. Furthermore, "too many regulations" is the second most popular reason why owners wish to downsize, sell, or close their business
- Too much attention has been given to the legal obligations required to start a company and less obvious barriers that restrict the growth or prevent liquidation have been neglected – as a result it takes a full year to close a business

- More than 25% of small business owners might potentially sell their business in the next few years, and two thirds have no plans to reinvest their capital

Taxation

- Any form of taxation that affects company profits has the potential to undermine socially beneficial entrepreneurship, and lowering business taxes is the surest route to building a culture of enterprise
- Global tax competition is increasing, and the UK is losing ground to European neighbours. By 2008/09 the combined burden of net tax and national insurance will hit a 20 year high
- Headline rates of corporation tax mask an increase in other forms of indirect taxation that stifle business growth
- Small businesses are increasingly bearing the brunt, with corporation tax rising from 19% in 2006 to 22% in 2009
- The main problem with taxation is its complexity and even well intentioned tax credits and other attempts to help SMEs simply add to their overall burden

Policy Initiatives

Financing:

- Increase the public transparency of public funds used to increase access to finance
- Reduce the compliance costs for business angels who invest as syndicates
- Large-scale "investment readiness" programmes for entrepreneurs
- Establish a virtual marketplace for unlisted investment opportunities

Skills:

- Improve entrepreneurial attitudes among young people
- Improve the business skills of students
- Encourage informal mentoring as a means of improving managerial skills

Innovation:

- Investigate the success of IP rights enforcement
- Improve collaboration between businesses and universities

Taxation:

- Simplify taxes
- Corporation tax is a tax on workers and should be reduced
- Make reinvestment more attractive

INTRODUCTION

The last few decades have presented an unprecedented period of global economic growth boosting prosperity and wealth across the globe. Many factors have sustained such growth, including the widespread doubling of productivity growth levels with respect to the preceding two decades (especially in the western world); to the "flattening of the world" thanks to liberalised markets, technology and process innovations; and the "empowerment" of consumers due to the widespread availability of information. All this has meant that for many businesses barriers are falling and trade has become increasingly global. There is a "reverse side to the coin" though, which is that companies have to find increasingly sophisticated ways to deal with the uncertainty that inevitably accompanies greater complexity. Product life cycles which used to last years, now can last only a few months; customers who used to be loyal can now change supplier at the stroke of a mouse. All this has had an impact on the economic environment as well as our lives. We have changed the way we communicate with each other (in terms of both the scale of communications and types communication channels); the way we work (from mostly leveraging personal skills to the use of technology such as PCs and software); the way we purchase goods (from buying locally with mostly cash to buying anywhere anytime via electronic means of payment); the way we travel (from short journeys by automobile to the full array of modern transportation); and even the way we eat (from mostly local products prepared according to local recipes to products and traditions from all over the world).

All these changes have been brought by innovations triggered by human discoveries in response to changes in the social, political, economic and technological environment. But innovations alone are not sufficient. They require entrepreneurs and innovative new firms that are capable of exploiting the opportunities arising by developing and commercialising products and services that provide the underpinnings to whole new ways of living. We call this multifaceted phenomenon *entrepreneurship,* and define it as, according to Wannekers and Thurik (1999), "the manifested ability and willingness of individuals, on their own, in teams, within and outside existing organisations to perceive and create new economic opportunities (new products, new production methods, new organisational schemes and new product-market combinations), and to introduce their new ideas in the market, in the face of uncertainty and other obstacles, by making decisions on location, form and the use of resources and institutions."

Entrepreneurship has, for many, become the key driver to propel economic growth. Increasingly public institutions and policy makers have started to research and implement initiatives to boost entrepreneurship with the clear intention of creating a healthy stock of new companies that can provide the economy with the necessary resources. As Van Stel et al (2006) argue, policy makers seeking to increase levels of entrepreneurship (often using new firm creation as a proxy) can proceed in a number of ways. The main choice is to either follow a route of either low regulation or high support. The low regulation route focuses policy on two areas. The first enables the start-up of a business to take place as quickly and cheaply as possible. The second sets to minimise the number and severity of regulations on businesses whilst operating or trading. The US is seen as the typical low regulation country. The alternative policy is for the government to provide "support" to new and small firms funded by the taxpayer. Such support can be in the form of information, advice, training, or finance to new firms or existing small firms. EU countries have traditionally favoured "support" policies.

The two routes are not mutually exclusive, and there is a lively debate around the world on the best policy mix to encourage entrepreneursip. Therefore, this study aims to analyse, in the context of Britain, the available data on what has been done to advance this debate.

Purpose of the study

The main objective of this report is to develop a set of policy guidelines that would improve the culture of enterprise in the UK and thus contribute towards making Britain the enterprise capital of the world. To retain focus and relevance of these policy guidelines, we are focussing on one specific aspect of entrepreneurship - the practice of starting and growing new organisations in response to identified opportunities. Our proposals will specifically concentrate on entrepreneurs with high growth ambitions that could substantially contribute to economic development. However, this is not ignoring the importance of the many thousands of smaller businesses whose owners intend to keep them small or to grow them only modestly. These firms also contribute greatly to our economy, while sustaining the lives of the owners and their families. But the relatively small fraction of all entrepreneurs who bring new or innovative products, services, or means of producing or delivering them to the market, deserve the attention of society the contribution they make to the economy and our standard of living.

Methodological approach

Following an extensive literature review, a series of industrial interviews with entrepreneurs, venture capitalists, and business angels were conducted to learn more about the state of UK enterprise. This was combined with new empirical evidence (provided in the Appendix) to create a number of suggestions that have been validated by a number of verifications such as focus groups and an online survey. Although we conclude with specific policy initiatives across a number of areas, these should be seen as part of a broad framework. Taken together, our suggestions form a coherent and congruent strategy of entrepreneurship policy.

Where suitable we compared the UK environment to relevant benchmark countries, however it is important to realise that our motivation is not to improve the UK's relative ranking. We do not feel that our objective is to "compete" with rival nations. Rather, the guidelines being discussed should be compared to the state of the country if these policies are *not* introduced. There are two visions of British policy: one that merely reacts to competitive pressures, and one that leads the way on facilitating enterprise. Regardless of the situation in other countries, whether the UK is ranked first in the world or last, these policies should be introduced because they will improve the entrepreneurial climate and thus facilitate social development.

Limitations

The aim of this research is to identify potential initiatives that would support the development of a more conducive environment for enterprise growth. Therefore by design, our results are broad and the level of detail, especially in terms of suggestions, does not go further than mere guidelines. Furthermore the fact that we explored a rather new dimension of analysis such as growth for which data has only recently began to be collected, represents a limitation since there are few comparable studies.

Structure of the report

The report is split into four sections. **Section 1** investigates the current state of entrepreneurship in the UK, by looking at levels of new firm creation and growth, and shows that it has been falling over recent years. Entrepreneurship involves both the perception and exploitation of profit opportunities, and we focus on both of these aspects. Successful exploitation of an opportunity depends on the barriers within the underlying environment; however the perception of an opportunity is both a cognitive and cultural phenomenon.

Section 2 looks at entrepreneurial culture, and the role of ambition in generating high growth companies. It focusses on the cultural context of entrepreneurial activity and the defining characteristics of potential high growth entrepreneurs. It will also include an analysis of the GEM reports and our own focus groups to explain the mental barriers involved in deciding to launch a high growth venture.

Section 3 surveys these barriers to growth along four axes: access to finance, human capital, regulation, and taxation. It will assess the entrepreneurial environment in each of the 4 categories, focussing on (i) the identification of barriers to growth, and (ii) a critical analysis of potential remedies.

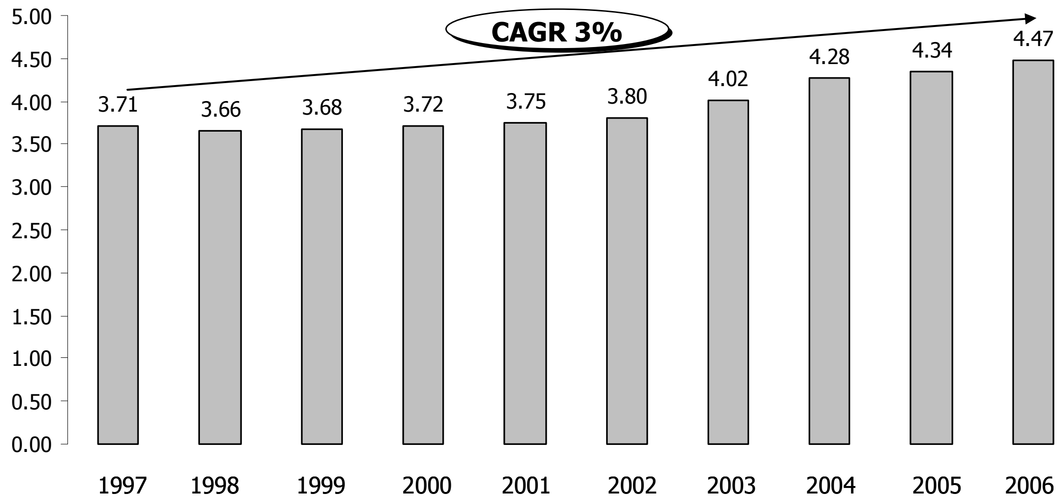
Section 4 concludes by presenting policy Initiatives that have been validated by experiences from other countries. This section will outline the ineffective nature of many proposed remedies, and then go on to clearly articulate and justify our Initiatives.

1. CURRENT STATE OF ENTREPRENEURSHIP

1.1 Evolution of the stock of companies

Despite the fact that the stock of companies has grown over the last 10 years, from 3.7 million in 1997 to over 4.3 million in 2006 (Figure 1), this does not tell us very much about the true state of entrepreneurship in the UK

Figure 1: Total number of companies, 1997 – 2006

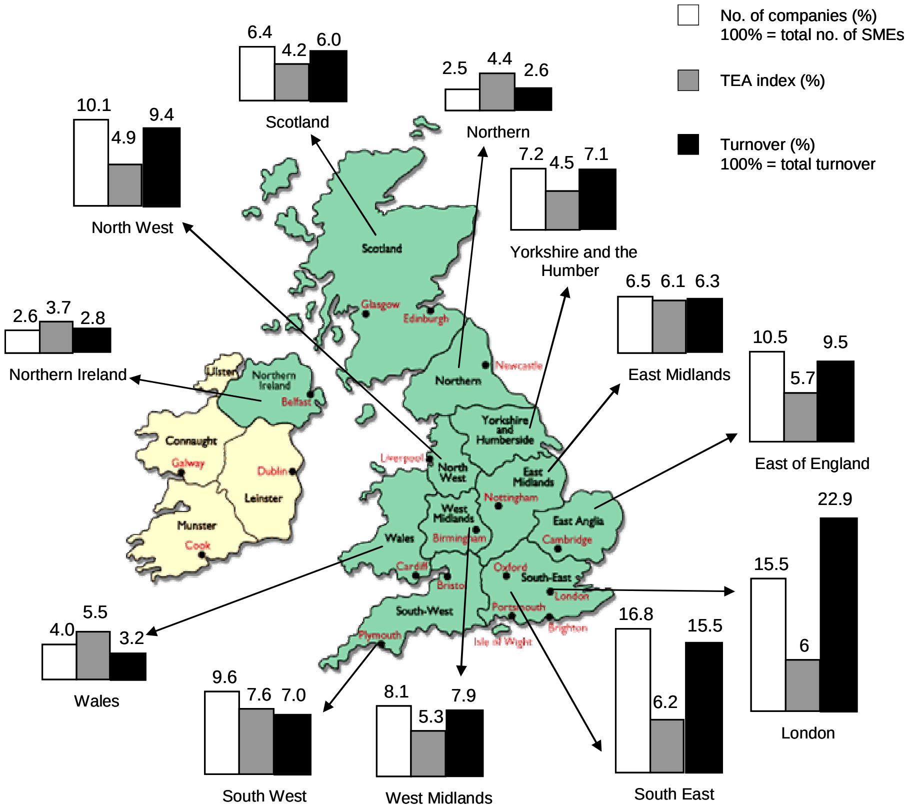


Source: BERR SBS Statistics Team (2006)

The growth has been driven by the financial and primary sectors (CAGR 3.7% and 2.9% respectively), and can be seen by the concentration of companies in the South East and London: one third of companies are located there, generating over 40% of the total turnover (Figure 2).

However the growth in absolute figures masks the fact that *population growth* is the main driver, rather than people becoming more likely to start a business. The start up rate per 1,000 inhabitants actually declined from a rate of 3.2 (per 1,000 inhabitants) in 1997 to 3.0 in 2007 (Huggins and Williams, 2007). In addition, Allison et al (2006) have analysed official figures and concluded that the major driver of this growth has been the growth in companies without employees (the number of such businesses increased by 22.1% over the period 2001-2005, compared with just 9.1% for businesses with employees). However, these businesses have lower rates of turnover growth (4.2%, compared with 12.2% for businesses with employees). Thus, while the number of businesses is increasing, there is the suggestion that many of the new businesses are without employees.

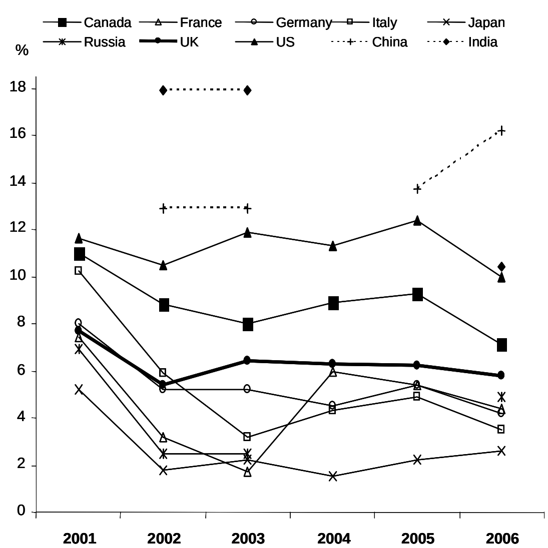
Figure 2: Number of companies by sector, 2000 – 2005



Source: SBS Statistical Unit (2006), GEM (2006)

The Global Entrepreneurship Monitor (GEM) also reports that the total entrepreneurial activity (TEA) index has also dropped, from 7.7% in 2001 to 5.8% in 2006. The UK TEA index is still 4 percentage points lower than the USA and 1 percentage point lower than Canada (Figure 3).

Figure 3: TEA* index, G8 countries, China, India



Source: GEM (2006)

**the proportion of adults of working age who are either setting up or have been running a business for less than 42 months*

1.2 Metrics of entrepreneurship

The reason we draw attention to these figures and trends is that firm creation is usually taken as a proxy for entrepreneurship. According to Mathews (2006), "It is now widely recognised that innovations tend to be carried out by new firms, while incumbents in general resist the innovations, through fear of undermining their hard-won advantages".

We believe that the number of new firms is not a perfect proxy for entrepreneurship, as it not does give an important insight into the dynamic flux of an economy. This is because it shows the extent to which capital is being reorganised in light of new entrepreneurial plans – the greater the "churn" of small businesses, the easier it becomes to coordinate resources.

It is also important to realise that once organisations reach a certain size, the capacity for genuine entrepreneurship becomes weaker. Although many large companies are able to develop so-called "intrapreneurial" capabilities, we attempt to partially capture this phenomenon by looking at the institutional environment for spin-offs. According to Schumpeter (1911):

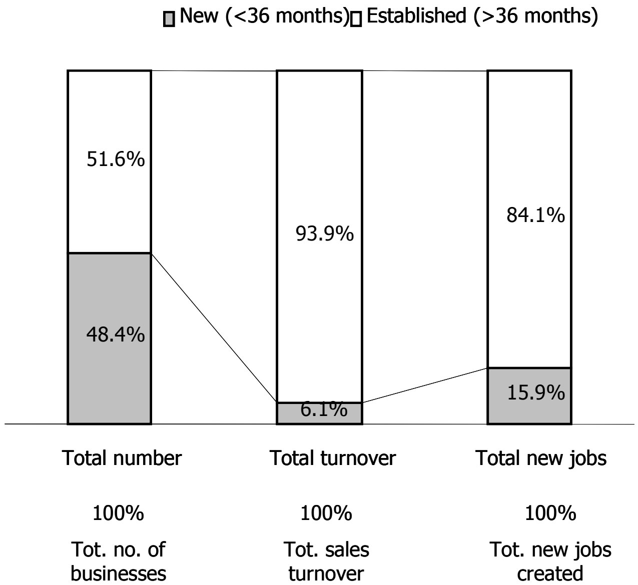
> *"Everyone is only an entrepreneur when he "carries out new combinations", and loses that character as soon as he has built up his business, when he settles down to running it as other people run their businesses"*

However, there is increasing empirical evidence to suggest that the relationship between "numbers oriented" entrepreneurship policies and subsequent job creation in the economy is not automatic and may in some situation even be negative (Mueller, 2007; Van Stel, 2004). Thus, we argue that more emphasis should be placed on the quality and speed of growth of new firms. Four main arguments support our assertion.

- Firstly, it is well known that many new businesses fail (30% within 3 years according to official figures from SBS Statistical Unit) therefore focussing only on the number of new companies offers a misleading indicator of subsequent wealth creation and economic potential.
- Secondly, new firms are an important driver for economic development, but they are not the magic bullet as the majority will not grow: In 2006, new companies (i.e. created in the past 3 years) represented 48.4% of the total number of companies, but contributed only 6.1% of the total turnover and only 15.9% of the total new jobs created (Figure 4).
- Thirdly, although medium and large sized companies account for less than 1% of the total number of firms, they are responsible for 63% of turnover and 53% of job creation in the economy (Figure 5).
- Finally, high growth businesses (those which have achieved an annual turnover growth of at least 30% in the last 3 years) are only 0.5% of all new businesses, but these few enterprises have a large impact: according to our analysis of financial data from the FAME database, their contribution to the total turnover generated by all the new businesses is

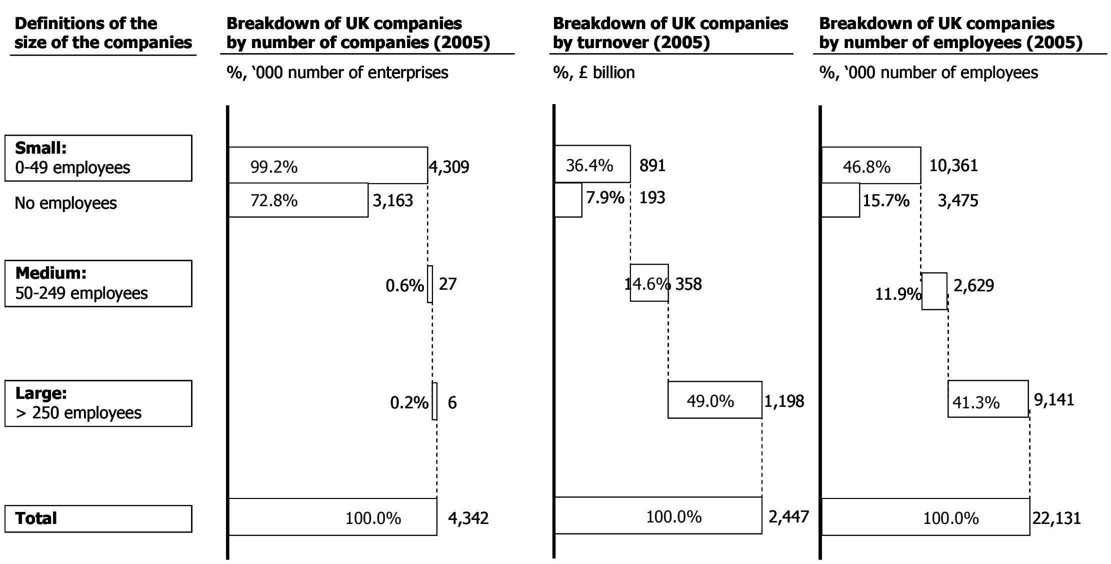
more than twice their number (1.1%) and their contribution to the total new jobs created by all new businesses is more than six times their number (3.2%). As underlined by Mason and Harrison (1999), "it is the small minority of fast-growth companies that is responsible for generating a significant proportion of new jobs and economic growth".

Figure 4: New versus established businesses, 2006



Source: ESCP-EAP team analysis of companies in the FAME database

Figure 5: Breakdown of UK companies by number, turnover and number of employees



Source: BERR SBS Analytical Unit (2006)

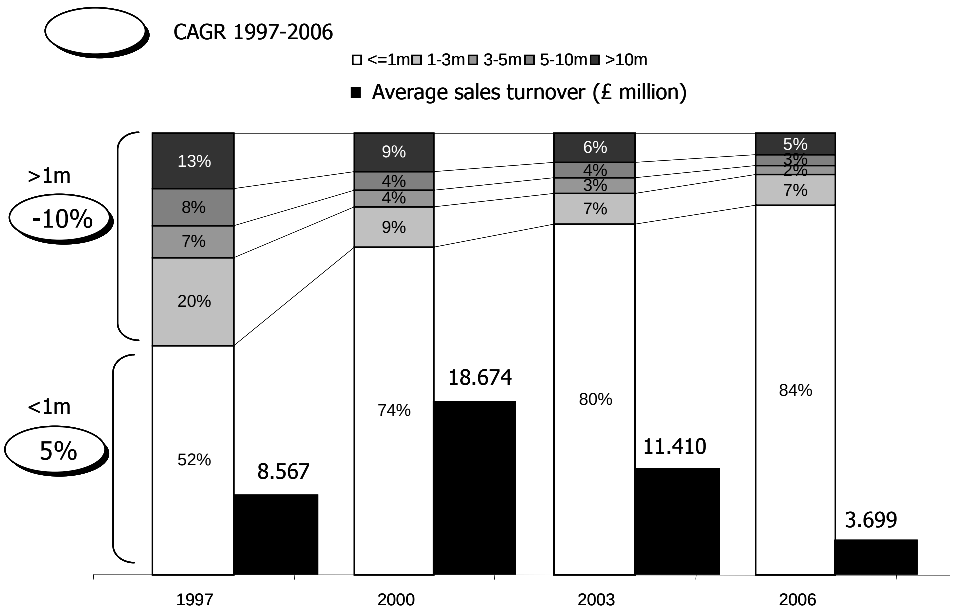
Given that almost three quarters of all UK companies have no employees (72.8%), it seems that current entrepreneurship policy is only creating a nation of freelancers, rather than healthy, ambitious companies that provide employment and growth.

1.3 Refocusing on growth

The previous arguments demonstrate that the source of growth and prosperity in the UK's economy does not lie with solo projects (the majority of new firms), but with companies that provide employment and grow to achieve a turnover beyond a certain threshold.

By analysing the last 10 years, we found that new businesses have increasingly struggled to grow in size. For example, the proportion of businesses that had achieved an annual turnover above £1 million 5 years after creation fell from 48% in 1997 to 16% in 2006 (Figure 6).

Figure 6: Breakdown of UK firms by turnover 5 years from creation, 1997 – 2006

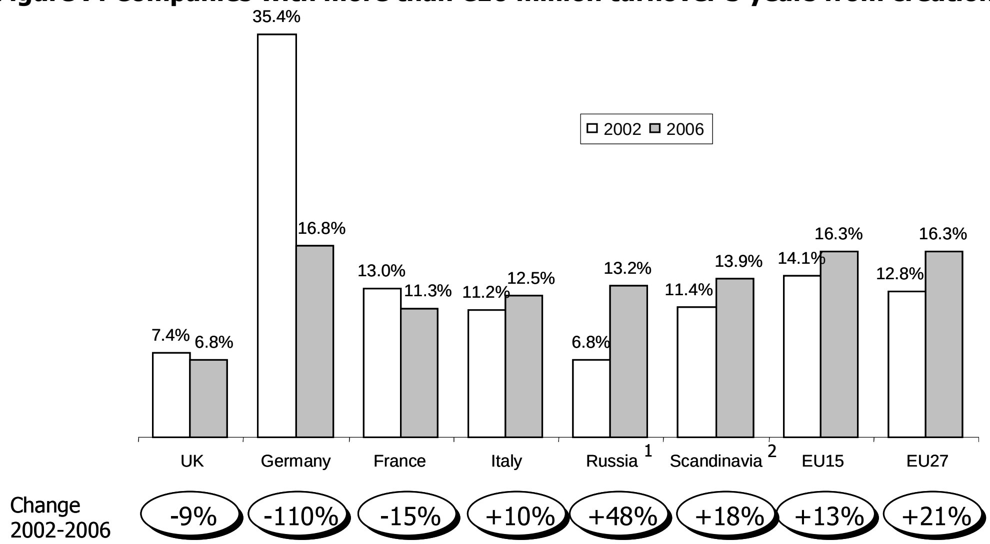


Source: ESCP-EAP Team Analysis of companies in the FAME database
Note: 100% represents the total number of businesses created 5 years before (different for each year)

The problem is that this is not only due to an increasing proportion of smaller enterprises. Our evidence shows two areas of concern when compared to the rest of Europe. Firstly, the proportion of UK companies with a turnover above £7m (€10m) 5 years after creation is lower (6.8%) than the EU15 and EU27 averages (16.3%). Secondly, the percentage of UK companies achieving this threshold has fallen by 9% since 2002, despite having risen across Europe as a whole (Figure 7).

This can be due to an increased number of small businesses vs. medium and large ones: we compared the trend in the UK trend to the one seen in Europe in order to test this hypothesis. In the UK, the number of companies with a turnover above €10 million after 5 years from creation has decreased by 9% in the last 5 years, while in the EU15 it has increased by 13% and in the EU27 by 21%. The UK trend is shared by Germany and France, while developing countries such as Russia and the Balkan countries included in the EU27, have the highest increase.

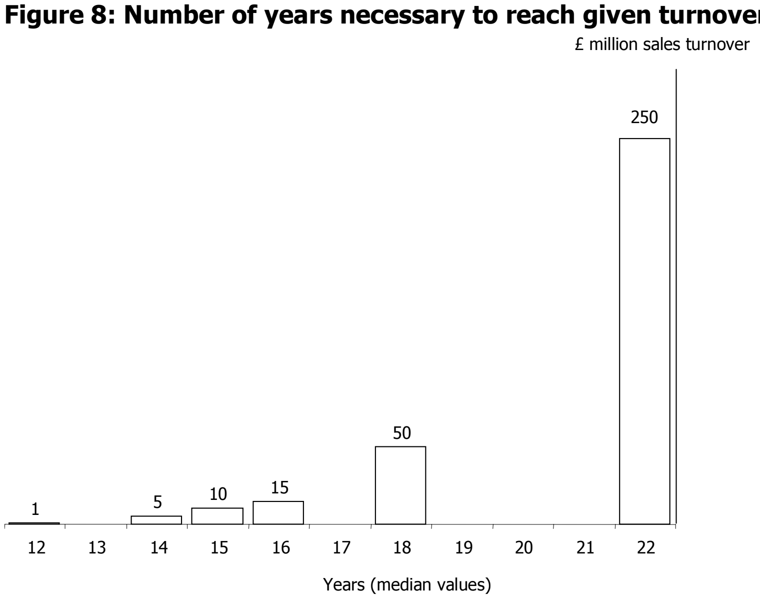
Figure 7: Companies with more than €10 million turnover 5 years from creation



Source: ESCP-EAP Team Analysis of companies in the FAME database

But it can also be shown that once this threshold has been achieved, further growth does not take a significantly long time to occur: the median time to hit £5 million is 14 years, whilst the median time to hit £15 million is only 2 more years (Figure 8). In fact, for those companies that have achieved revenue above £250 million, on average took longer to grow from 0 to £1 million, than to grow from £1 million to £250 million.

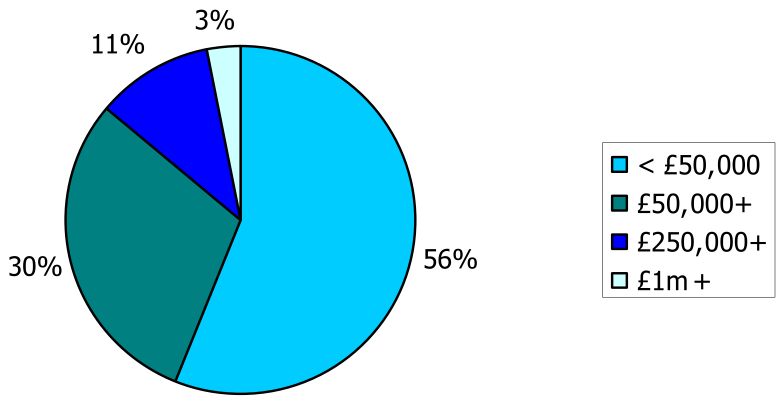
Figure 8: Number of years necessary to reach given turnover values, 1997-2006



Source: ESCP-EAP Team Analysis of companies in the FAME database

This helps to explain why many small and medium sized companies have been established for a long time (58% have been established for more than 10 years), 86% of them have revenues of less than £250,000, and only 3% achieve a turnover more than £1 million after two years of existence (Figure 9).

Figure 9: Turnover after 2 years of existence



Source: Barclays Small Business Banking report, 2006

This lack of growth is noticeable in the ambitions of business owners, as only 38% intend to grow their business within the next 12 months. The larger the organisation, the more probable it is that they are planning to expand: according to the Tenon Forum survey 2005, 65% of business employing between 200 and 499 staff expect to expand compared with 21% of businesses with 5-9 employees and 51% of businesses with 10-199 staff.

All this suggests that a lot of businesses in the UK are either not intending to grow (a mental or cultural issue) or having great difficulty in achieving it (an environmental barrier).

In summary, we highlighted the following issues in this section:

- The quality and speed of growth of new firms is a more appropriate proxy for entrepreneurship than the number of new firms
- New companies have increasingly struggled to grow in size (our analysis shows that the percentage of businesses that achieve an annual turnover above £1 million 5 years after creation has decreased from 48% in 1997 to 16% in 2006)
- There is a growth threshold – once companies reach a certain size, growth becomes much faster (our analysis shows that it takes on average 14 years for a company to reach £5 million in annual turnover and only 2 more years to hit £15 million)
- This struggle for growth can be explained by two factors: a mental barrier (business owners not aspiring to expand their businesses) and an environmental barrier (business owners finding it difficult to achieve growth)

2. ENTREPRENEURIAL CULTURE

Culture has often been used to explain why entrepreneurial activity is higher in the US than in Europe: "culture can shape what an individual perceives as opportunities and thus what he overlooks, as entrepreneurship is always embedded in a cultural context" (Kirzner and Sautet, 2006, p.17). We believe that alertness to profit opportunities and judgement under uncertainty are essentially cultural phenomena.

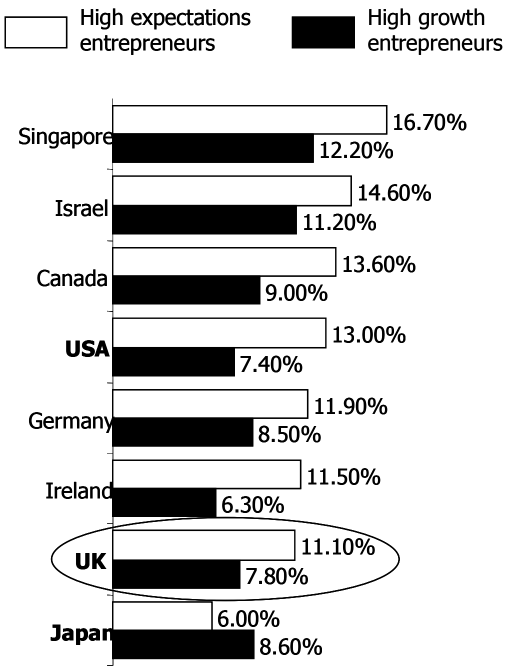
We contend that barriers to entrepreneurship might be significantly reduced via intelligent policy reform, but if the cultural environment isn't compatible this will not make a difference. According to Huggins and Williams (2007), "without a culture conducive to enterprise, government actions to increase levels of enterprise may not be realised" (p.7). Therefore before looking at the barriers to entrepreneurship it is necessary to assess the current climate of opinion. To do this we have split the cultural environment into five themes: level of ambition and expectations; fear of failure; attitudes to wealth creation; role models; and media coverage of entrepreneurship

2.1 Level of ambition and expectations

Since expectations precede action, entrepreneurs must have a vision before they engage in profit seeking activity. Consequently the strength of that vision, their ambition, is a crucial pre-determining factor of success. Therefore, it is worrying that only 11% of new entrepreneurs expect to employ more than 20 employees in the next 5 years (GEM, 2006).

The GEM defines "relative prevalence rate of high-growth entrepreneurs" as the share of established entrepreneurs (those who have been in their role for more than 42 months) who employ more than 20 people, divided by the total population of entrepreneurs within the given country. The "relative prevalence rate of high-expectation entrepreneurs" is the share of the nascent and new entrepreneurs (<42 months) who expect to employ at least 20 employees within the next 5 years, over the total population of entrepreneurs in a given country. By comparing these two rates - analysing the difference between the expected high-growth rate and the actual one - we can infer the climate of expectations (Figure 10). Three different entrepreneurial trends can be identified, the optimistic, like the USA (2nd in terms of expectation, but only 16th in terms of effective high-growth); the realistic, such as the UK (11th in terms of expectation and 14th in terms of effective high-growth); and the pessimistic, such as Japan (an expectation rate almost 4 times lower than the growth rate).

Figure 10: Relative prevalence rate of high-expectation and high-growth entrepreneurs



Source: GEM, 2006

The Flash Eurobarometer study 2007 provides some more interesting findings about the ambitions and expectations of people through the European Union. Thus, people in the UK, by and large, find the prospect of becoming self-employed undesirable to a larger extent than people in countries like Portugal, Italy, and Ireland.

The same study also suggests that, across the EU, including the UK, the goal of becoming self-employed is perceived as unrealistic. The UK is more pessimistic than other EU countries, with only 30% of respondents perceiving the prospect of becoming self-employed feasible in the next 5 years, a percentage significantly lower than the Scandinavian countries (50%), the US (44%) or Ireland (40%). The study concludes that people in the UK do not consider entrepreneurial activity as a life-long choice, but on the contrary, only a stage in a flexible career path that can swing back and forth between self-employment and working for a firm.

Finally, in the UK, the Household Entrepreneurship Survey 2005 found that the percentage of 'Doers'[1] has declined from 18% in 2001 to only 13.1% in 2005 and that the proportion of 'Thinkers'[2] has remained relatively constant, at 11%. On the other hand, the report indicates that the structure of those two groups has changed, with more Thinkers and Doers who are either male or female aged 16-24. This means that the uptake of entrepreneurial activities among young people has increased, however there is still a significant gap between intentions

[1] Doers are those who are self-employed or own a business (fully or partly), either as their main activity or as a sideline to their normal employment activities.
[2] Thinkers are those who are not currently Doers, but have recently thought about starting a business, buying into an existing business or becoming self-employed.

and actions, as the same study found a gap between the percentages of Thinkers and Doers among the 16-24 age group, where 18% are Thinkers, but only 6% are Doers.

An interesting addition to this issue of levels of ambition and expectation comes from the results of our online survey. We asked the respondents about their intention to grow their businesses and found that 42.5% plan to expand moderately and 40% plan to grow rapidly. While this is an encouraging finding, the way these respondents envisage growing is mainly by increasing their sales with the existing product targeting the same market (53.5%). Only 20.2% envisage moving into new markets and 18.2% introducing new products/services, which is worrying as innovation and expansion are key elements to business growth and success. Finally, we also asked them about their expectations, in terms of increased revenues for the next 12 months, and found that 83.3% expect revenues to grow. Among those, 60.2% expect it to not grow more than 30%, another 24.1% expect it to grow between 31% and 99%, and the remaining 15.7% expect it to double or more. These last findings confirm the growth plans that our respondents initially stated. The fact that these figures are much higher than the official ones presented in the first section of our report are most likely a result of the inclining of our sample towards older, established and more experienced entrepreneurs.

Our profile of 100 high growth entrepreneurs and the findings of our online survey highlight the importance of higher education, prior industry experience, and maturity. Although it is difficult to identify telling psychological characteristics, it is clear that a passion for a particular vision is a more pressing motivation for entrepreneurs than pecuniary rewards or an appetite for risk taking.

> *"To start a business you have to be hungry"* (Interview with an entrepreneur)
>
> *"I made a mortgage on my house to fund my business, you have to be really motivated to start your own activity"* (Interview with an entrepreneur)

We conducted focus groups with individuals possessing similar characteristics to explore the mental barriers that might hold them back. The key insight from these focus groups is a fear of failure that derives from a tendency toward lifestyle security.

2.2 Fear of failure

Despite some improvement in opportunities and self-confidence, the fear of failure has increased in the UK (from 30.1% in 2001 to 35.8% in 2006). A recent HM Treasury report (2006) confirmed these findings by showing that under half of the UK population believe they have the experience, knowledge, and skills required to start a business. Furthermore, the Household Entrepreneurship Survey 2005 identified the fear of getting into debt, the chance that the business might fail, and the fear of losing security of the current job as the most frequently mentioned cultural barriers to starting a business or becoming self-employed.

In fact this fear over the risks associated with starting a business is higher in the UK than in the US or EU. According to the Flash Eurobarometer study 2007, the difference between the UK and EU is particularly evident in the fear of losing personal property and the uncertainty of income. People in the UK are noticeably more risk averse than US when it comes to bankruptcy and personal assets. At the same time, the study reveals that people in the UK have become increasingly more risk averse over the last 4 years, as 43% (compared with 34% in 2004) now believe they shouldn't start a business if there is a risk it might fail, compared to only 19% in the US.

Finally, according to the LSE report (2003), UK entrepreneurs do not see themselves as risk takers (only 3% of respondents described themselves in that way). On the other hand, the results of the report indicate that the willingness to take risks is a part of the entrepreneurial mix, but not a definitive one, as 'ambition' (86%), vision (85%), ability to spot opportunities (85%) and creativity and innovation (81%) are considered to be far more important.

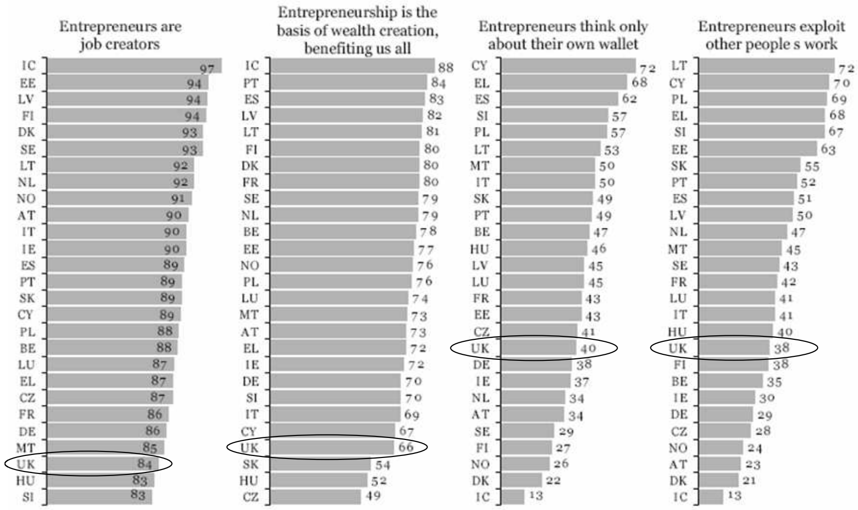
> *"People are really scared to leave their secure job and start a new business. We should have a system where it is easier to be reintegrated in to the previous job (e.g. university) if you fail with your own company"* (Interview with an entrepreneur)

While we have already demonstrated that this seriously affects the propensity of individuals to start their own business, there is increasing evidence (e.g. Allisons et al, 2006) that small business owners display the same type of risk aversion when in comes to the perspective of growing their business. They believe that failure is more likely to happen in a situation of growth than of relative stability. Thus, they seem to be reluctant to consider jeopardising their present situation as they are content with their current situation, and fear that any change will cause incontrollable disruption.

2.3 Championing wealth creation

The Flash Eurobarometer study 2007 found significant differences between the UK, EU and the US, in terms of perceptions of entrepreneurs as job creators and of entrepreneurship as the basis for wealth creation: fewer British respondents agreed with these positive statements about entrepreneurship than their European or American counterparts (Figure 11). On the other hand, when it came to the common negative perceptions of entrepreneurship (e.g. "entrepreneurs think only about their own wallet" and "entrepreneurs exploit other people's work"), there were significantly more British respondents agreeing with these statements than Europeans or Americans. These figures show that the public perception of entrepreneurship as a basis for wealth and job creation in the UK is much less favourable than in other EU countries and the US.

Figure 11: Image of entrepreneurs in individual countries, % agree



Source: Flash Eurobarometer, 2007

Thus, the UK needs to replace a culture of envy with a culture of emulation – entrepreneurial success should be a source of inspiration rather than a fortuitous bounty. The degree to which society either reinforces or weakens the celebration of wealth creation is crucially important to determine the cultural environment and it is often politicians responsible for undermining it. Phrases such as "profiteering", "scalping", or "price gauging" are sure indicators of economic illiteracy and broader public education – including politicians – is required.

> *"We need to create a more positive attitude towards the idea of independent business and profit. We need to correct the view of what business is all about"*
> (Interview with an association)

2.4 Role models and media coverage of entrepreneurship

The prevalence of role models is crucial for nurturing a desire to create a high growth enterprise, and we find that the promotion of role models, who young entrepreneurs look up to, by the media, lags behind. This suggests that informal and personal networks are more important than focal points, implying that policy must be broad rather than targeted.

People feel that media coverage of entrepreneurship has dropped since 2003 (56.2% to 54.6%), although personal contacts with entrepreneurs have been moderately increasing. 74% of the respondents to our online survey also felt that mass media cover entrepreneurship little or not enough.

In addition, the Eurobarometer study found that managers of large companies are perceived to have a higher social status than entrepreneurs or civil servants, both at the UK and EU level. On the other hand, people in the US are more likely to have a balanced view of all three categories. These figures confirm once more that the entrepreneurial culture is much more developed in the US than in European countries.

This means that the UK needs a change in terms of publicity and media-entrepreneurs relations. The lack of a sufficient spread of positive role models through media is reflected also by the partial persistence of a negative label of 'entrepreneurs' by British society: according to the LSE report, only 6% of people felt entrepreneurs were considered as heroes, whereas 24% saw them as 'respectable business persons', and finally the same percentage defined them as 'chancers'.

The entrepreneurs interviewed in the LSE report underlined the importance of media in bringing entrepreneurship to the mainstream and the change of its meaning: the format "The Apprentice" is interpreted as a representation of the old generation of entrepreneurs, while "Dragon's Den" is a better representation of modern entrepreneurial values. Nevertheless, both young and old entrepreneurs felt that the celebrity emerging with these TV programs goes against some core values such as hard work, substance, and drive. The reason for this dissociation is a shift in defining the concept of entrepreneurship and how entrepreneurs see themselves. As a result, a third of the respondents to our online survey indicated that nobody among the public role models inspired them to engage in entrepreneurial activities. Conversely, 21% felt inspired by people from their business networks, and another 21% by older family members. This indicates the major importance of personal networks and mentoring as key elements in the decision of starting a business.

According to the LSE Report (2003), the post dot.com boom entrepreneurs see themselves not as anti-establishment heroes with unlimited ambition of growth and wealth but creative and dynamic people: as a matter of fact, only 50% of them considered "Profit" as the main reason driving them to set up a business whilst 63% considered innovativeness the leading variable. Moreover, the top three reasons for owning a business are creating something (72%), will to make money (65%) and control over one's time (62%).

The LSE report 2003 concluded that a famous entrepreneur (Richard Branson) was one of the most mentioned positive role models because of his ability to keep the business profitable, while being motivational and inspiring, followed by owners of internet sites. Our own findings indicate that famous entrepreneurs or managers inspired only 9% of the respondents to our online survey, which might indicate a shift in attitude and aspirations in the past 4 years, from looking up at 'celebrity' entrepreneurs to developing a much stronger sense of entrepreneurial 'community' and focal points within one's own network.

Conclusively, a positive trend emerges with respect to the acceptance of entrepreneurship in society, but the lack of modern role models aligned to the new concepts, values, and ideas that young entrepreneurs would like to represent and express is mitigating this process of acceptance. British entrepreneurs seem to possess a realistic attitude towards their prospects for high growth, and therefore the underlying cultural environment is compatible with greater economic development. In short, the UK is underachieving, and reducing barriers to growth will continue to improve the cultural foundations of entrepreneurship.

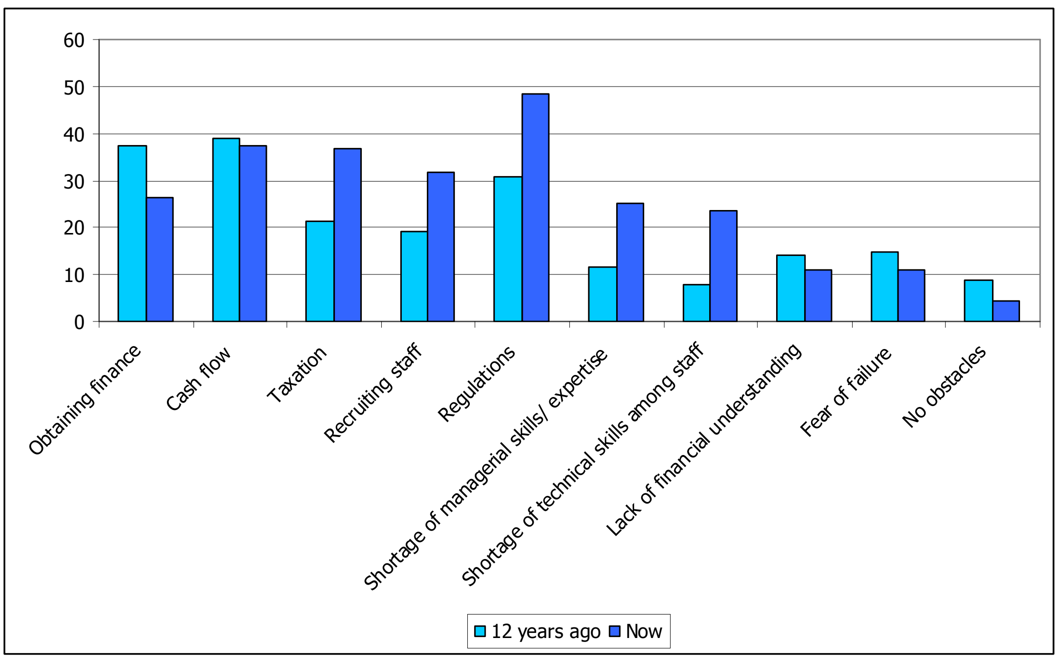
In summary, we highlighted the following issues in this section:

- Individuals in the UK are less inclined to start a business than in other G8 countries
- Across the EU, including the UK, the goal of becoming self-employed is perceived as unrealistic –more so than in the US
- UK entrepreneurs have become increasingly more risk averse, particularly in terms of bankruptcy and personal assets
- Fear of failure is a major factor reducing the pool of UK entrepreneurial talent
- The public perception of entrepreneurship as a basis for wealth and job creation in the UK is much less favourable than in other EU countries and the US
- There is an insufficient spread of positive role models through the media
- UK entrepreneurs do not relate with the role models promoted by media, but they emphasize the importance of personal networks

3. ENVIRONMENTAL BARRIERS

This section provides more concrete analysis of the actual barriers that obstruct entrepreneurial discovery and company growth. Furthermore, it gives some preliminary insight on how to overcome such barriers, which have been verified through an international benchmarking of the most effective entrepreneurship policies, and an online survey that subjected these Initiatives to an array of business owners. Whilst these methods provide initial validation, more detailed proposals would require further testing. After surveying the literature and conducting preliminary interviews, we have identified four areas where entrepreneurs face barriers to growth: access to finance, human capital, regulation and taxation. Together, these four elements represent barriers to growth for 95% of the respondents to our online survey. In order to gauge the relative importance of these factors and the way their impact on business growth has changed over the last several years, we asked them to identify the most important obstacles to their business, when they started (on average 12 years ago) and at the present moment (Figure 12).

Figure 12: Obstacles to business success, 12 years ago and at the present



Source: ESCP-EAP team analysis of online survey

The findings indicate that taxation, regulations and human capital (recruiting staff, managerial expertise, skilled workforce) have increased their negative impact on business success over the last 12 years (on average). We will look in detail at each one of these factors and unpick the main issues that should be targeted by the policy makers in their efforts to lower the environmental barriers to entrepreneurial success.

3.1 Access to finance

Because of liberalised financial markets and the UK's status as an international financial centre, we should expect few barriers in acquiring the finances required to start a firm.

3.1.1 Required financing

Although the government seems to have identified access to finance as being a major problem facing potential entrepreneurs, we believe that it is has long been a source of strength due to the UK's long tradition of financial and legal development. The UK is ranked first in the world for "getting credit" by the World Bank's "Doing Business Survey" 2007, mainly as a result of the financial liberalisation of the 1980s

According to the Annual Small Business Survey 2005, 79% of entrepreneurs reported that they had "no difficulties" in finding external finance, and only 13% that they had failed to obtain any finance at all. A study by Fraser (2004) showed that of those businesses who weren't seeking finance, 95% do not feel that they need it. Furthermore, our online survey findings indicate that one third of our respondents have always received as much finance as they required.

Moreover, our respondents indicate that, in general, obtaining finance becomes easier as the business grows. Thus, 62% and 67% of the respondents found obtaining finance difficult at the business idea and at the seeding stages, respectively. On the other hand, experiences are divided when it comes to obtaining finance at the start-up and early growth stages, when more than 40% reported difficulties, and around 35% indicated a fairly easy process. Finally, 52% reported no difficulties in obtaining finance at the mature growth stage.

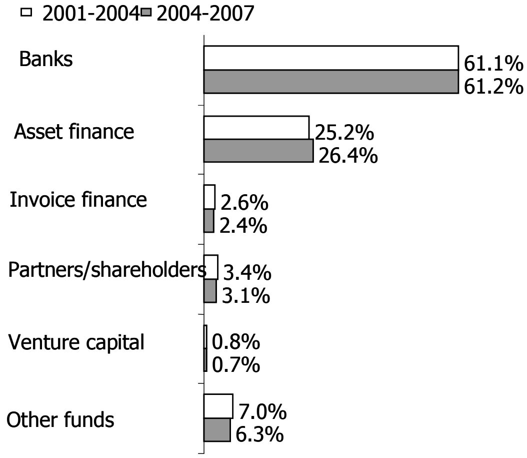
Clearly there is a wide distribution of finance that is required depending on the nature and scale of each start up, however the patchy information that is available is telling. The Fraser (2004) study showed that the average (mean) amount of finance that is used for a start-up is £71,000, and the median amounted to only £15,000. This demonstrates that although half of all start ups cost less than £15,000, there is a small number that involve much larger amounts of capital.

3.1.2 Finance sources

Almost 70% of new businesses are financed through personal savings and these are the *primary* source of start-up finance for 65% of businesses less than 2 years old. Loans (either from banks or family/friends) account for 10%, while no other source of financing is in double figures (Fraser, 2004). This demonstrates a clear wealth effect, since ability to exploit entrepreneurial discovery depends upon access to resources.

The use of external finance increases with the number of employees and turnover. It varies from 75% (no employees) to 98% (50-249 employees). There are various sources of external finance for SMEs, among which bank loans and overdrafts and asset finance are the most commonly used. Venture capital and other funds, in contrast, are much rarer (Figure 13).

Figure 13: Sources of external finance



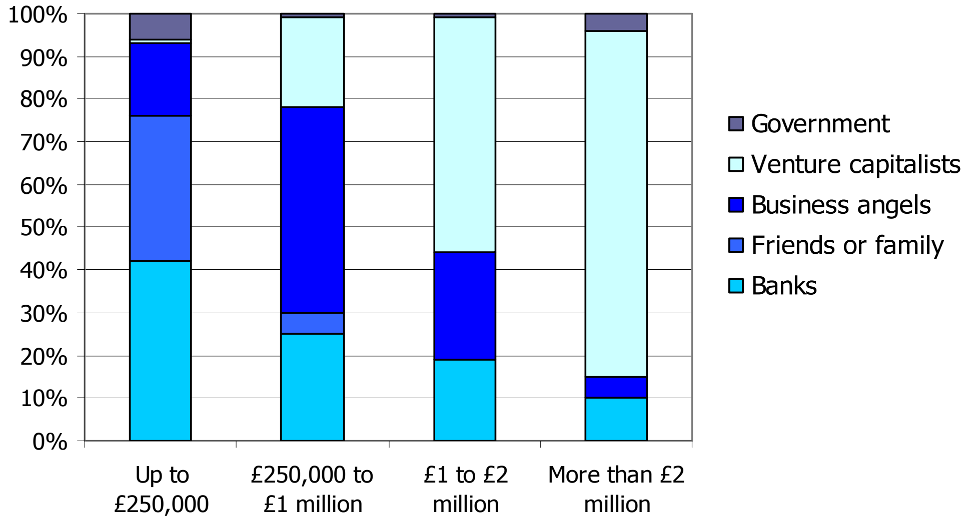
Source: Keynote, 2007

Financing is essential to fast growing companies, therefore it is important to look at the situation regarding *new* finance in addition to *external* finance. Almost half of SMEs sought new finance in the period 2001-2004, and this percentage varies from 36% (no employees) to 76% (50-249 employees). Start-ups are more likely to have sought new finance than established businesses (69% versus 42%), but most importantly, 62% of high growth businesses sought new finance versus 41% of slower growing businesses (Fraser, 2004).

Our online survey indicates that 34% would fund their business growth using internal financing, whereas only 20% would use external financing and 45% would use both. This preference for internal finance is confirmed by the focus groups undertaken by Allinson et al (2006), who report that there seems to be a negative attitude towards many sources of external finance and small business owners perceive handling over control of ownership in exchange for finance as an important disincentive.

Other interesting findings from our online survey related to the perceptions of entrepreneurs on the likelihood of success in obtaining different levels of finance from various external sources (Figure 14). Thus, banks as well as family and friends are considered the most likely source of finance for amounts up to £250,000. Business angels are the most widely perceived sources of finance for the intermediary category of £250,000 to £1 million, whereas venture capitalists hold the power for larger amounts. Interestingly, public funds are considered a likely source only for small or very large amounts, and only by 5.5% and 3.9%, respectively, of respondents.

Figure 14: External sources of finance



Source: ESCP-EAP team analysis of online survey

3.1.3 Equity gap

Although external sources such as venture capital are rare, they are imperative for fast-growing firms who require more funding than personal credit limits provide. Fast growing business often require an investment between £250,000 and £1,000,000, and this is often larger than business angels are willing to invest, but lower than where venture capitalists typically operate. The "equity gap" is defined as the range of investments between what business angels and venture capitalists are willing to lend. However this raises a number of issues.

Firstly, there is no consensus on whether the 'equity gap' exists. According to the European Private Equity and Venture Capital Asssociation (EVCA) report 2007, funds leverage more resources in the UK than they actually invest, suggesting that there is an available supply of capital for appropriate investments. Thus, it seems that the issue is more about resource coordination rather than resource availability.

> *"The equity gap is only partially a financial problem, most of the time money is around but people don't have the right skills to grab it. Equity gap is a matter of "quantity" and "price", for every good business there is a price at which money could be raised"* (Interview with a business angel actively investing in the range classified as "equity gap")

> *"No real equity gap exists; asymmetry of information and communication is the source of an accessibility problem"* (Interview with an association who advises companies seeking financing)

Secondly, there have been many attempted solutions with unclear success. The first major attempt to plug the equity gap occurred through the Small Firms Loan Guarantee Scheme

(SFLG) and targeted investments in the range of £100,000 - £250,000. In its 2003 report "Bridging the Finance Gap" the government identified a gap in the equity funding of small businesses for amounts between £250,000 and £2 million. The report estimated that between 9,000 and 18,000 firms would be suitable for such equity investments each year and that existing sources of equity financed between 3,000 and 6,000 firms. By the end of December 2005, Government-backed equity finance schemes (e.g. Enterprise Capital Funds Scheme) had invested £215 million in 558 businesses. But these schemes could not invest the full amount and the financial returns of the funds invested are not clear as the schemes lack transparency.

Thirdly, levels of investment are vastly different across geographic regions, and are related to general economic development (BVCA, 2005). It is important to realise that the cause and effect is likely to lead from general economic prosperity to the amount of financing available, rather than vice versa.

Following the suggestions of experts that were collected during the interviews, this gap occurs more in the less developed regions: due to the lack of infrastructure, angels are not able to cluster together in a club in order to invest heavily in viable projects (SBS, 2005).

The Labour government has attempted to tackle this problem with regional venture capital funds initiatives. The initiative has been strongly criticised by authors such as Mason and Harrison (2003), who argue that:

1. There is a lack of early stage venture capital skills available to manage the funds
2. The small size of funds will make achieving financial viability difficult
3. The funds are targeting the wrong problem (the maximum investment they are allowed to make is £250,000: they may subsequently provide up to an additional £250,000 in follow-on financing. However the main funding gap in the UK is in the range between £250,000 and £2,000,000).
4. The proposal ignores the role of the demand side constraints in contributing to the equity gap.

If there is a genuine market failure, we should expect these funds to generate profits, and over time for private companies to compete. Although it is commendable that the government realises that grants are burdensome and therefore self-defeating, they misdiagnose the underlying problem. The fact that most businesses find support through the private sector, and report they are unaware of the services offered by the public sector, should not be a signal for authorities to spend more resources on trying to compete. Rather, government should spend more time understanding the nature of services offered by the market and avoiding crowding it.

We interviewed an investor who set up a fund that explicitly targeted investments in the range of £250,000 - £1 million. He acknowledged that venture capitalists are reluctant to look at investments under £2 million, and that many business angels shy away from larger deals as they are too risky. This presents a difficulty for companies looking for early-stage financing. However, "starting from these points, we decided to build our business", entailed a network of 30-40 high net worth individuals investing under a hybrid model. Although this investment strategy had high start up costs, the fund is now profitable and is a good example of how private companies are developing successful financing strategies without government help. Indeed this evidence suggests that focussing on a financing constraint is a misnomer, and the real issues are (i) a lack of skills on the part of entrepreneurs to convince investors that their projects are profitable, and (ii) barriers that prevent wider business angel networks from spreading to less developed regions.

Access to finance is only one part of what constitutes successful entrepreneurship, and we cannot reasonably judge whether a venture is profitable regardless of the ability for the entrepreneur to acquire funds. In a well-functioning capital market, if private investors are unconvinced by the profit potential of a plan, there is no rational alternative judgment.

> *"If a company has a good business plan they will raise the money - there are too many bad companies looking for money"* (Interview with a business angel)
>
> *"Access to finance is not a problem in UK, the real problem is the lack of managerial skills and the aptitude of people - they are too risk adverse in this country"* (Interview with a business angel)
>
> *"The equity gap is only partly a financial problem. Most of the time, money is around but people don't have the right skills to grab it. The equity gap is a matter of "quantity" and "price" - for every good business there is a price at which money could be raised"* (Interview with a business angel)

We have found evidence that suggests market solutions are emerging to correct these issues and have spoken to people who provide entrepreneurs with a service that helps them to pitch their ideas. They specialise in developing a bridge between entrepreneurs and investors, taking a cut (of 5% in the case we are aware of) in exchange for helping to secure the financing. These somewhat complex developments need to be monitored further, prior to any intervention that attempts to replicate what is already occurring.

3.1.4 Private equity

It is important to realise that the enterprise environment facing potential high growth companies is far larger than the simple set of direct incentives faced at any one moment in time. Even though private equity companies are not a typical source of investment for the types of company that we are focussing on, the availability of private equity to larger firms is important for three reasons. Firstly, it provides an incentive for an entrepreneur to commit to a high growth plan. Secondly, it is likely to produce a trickle-down effect, as competing venture capitalists are forced to search earlier in the company life cycle. Thirdly, various studies have highlighted the importance of venture capital to an innovative environment.

For example, after studying 20 manufacturing industries in the US over three decades, Kortum and Lerner (2000) found that venture capital is associated with an increase in patented innovations. It is worrying then to notice that venture capitalists invested only about £4.5 billion in the EU, compared with more than £20 billion invested by American venture capitalists. Similarly, the OECD highlights the importance of venture capital to innovation: venture capital is "a major source of funding for new technology-based firms and a influential determinant of entrepreneurship and innovation".

Fortunately the current climate for private equity in the UK is very strong, although this strength has generated media attention, it is important to stress that this report is based on economic reasoning. A study by the Centre for Management BuyOut Research, at Nottingham University Business School found that on average, employment had risen by 21% after four years of a British private equity deal. Although employment dipped by 5% in the first year, the long-term benefits also include a doubling of productivity and an increase in innovation and investment. It is unfortunate that critics of private equity firms focus on the short term effects of a takeover, because studies tend to find that levels of employment, employee empowerment and wages rise following these types of deals. This evidence supports the simple economic argument that private equity is a vital means to correct existing misallocations of capital and deliver beneficial long-term growth.[3]

The British Venture Capital Association (BVCA) commissioned IE Consulting to investigate how private equity affects the British economy, and report that about a fifth of private sector employees (2.8 million people) work for companies that have at some stage received financial backing from private equity. Of those companies that have received private equity support, 92% of respondents said that without it they would either not have existed, or have developed less rapidly. The number of people employed in private-equity backed firms grew at 9% pa, compared to 1% for FTSE 100 companies, and 2% pa for FTSE Mid-250. Private equity backed companies saw their sales rise by 9% pa (after five years), compared to 7% pa for FTSE 100 companies, and 5% pa for FTSE Mid-250. Also, investment rose by 18% pa in private equity firms as opposed to 1% nationally (BVCA, 2006).

It is possible to argue about the precise economic impact of private equity, but there is certainly enough evidence to support the view that private equity has an important role for enterprise. The bottom line is that the growth drivers are highly mobile investors. The technical argument about whether carried interest should be taxed as income or capital gains is beyond the scope of this report. However, it is important to stress the negative unintended consequences of

[3] British private equity deals (2006), by the Centre for Management BuyOut Research at Nottingham University Business School. Also see "The real reason why private equity is under fire", by A. Kaletsky in The Times 20th June 2007

regime uncertainty. We encountered numerous investors through the course of our interviews who expressed concern that tax laws might change, and are therefore seriously considering a move.

In summary, we highlighted the following issues in this section:

- External sources of finance are imperative for fast growing companies, and a healthy venture capital industry not only offers a source of funds, but provides an incentive for entrepreneurs to build high value firms
- Government attempts to provide access to finance are misdiagnosing the problem, and turning profit-seekers into grant-seekers
- There is no shortage of financing available to UK entrepreneurs, however better coordination would improve the prospects of high growth businesses finding support
- Business angels find it costly to participate in syndicates, and the amount of funding available to entrepreneurs could be increased if these costs were reduced

3.2 Human capital

In order for a successful business to grow, three ingredients are essential: a commercially aware entrepreneur (with management capabilities); a highly skilled work force (to provide a pool of available talent); and a sequence of innovations (that can be turned into business ideas). These form the basis of the human capital necessary to support an environment conducive to entrepreneurship.

3.2.1 Managerial capabilities

Basic managerial capabilities – and the commercial acumen that comes with them - are an imperative skill-set for high growth entrepreneurs, so it is worrying that PKF Accountants, the UK advisory firm, has found that over half of UK SMEs do not have a business plan.[4] Furthermore, many small firms lack the will to engage in business planning, and the basic capacity and skills to undertake strategic thinking and planning (Allinsons et al, 2006).

According to the Flash Eurobarometer study 2007, only half of people in the UK believe that school education helped them develop an entrepreneurial attitude, and even fewer (29%) believe that school education made them interested in becoming an entrepreneur. When comparing these results with those obtained from other European countries, significant differences become apparent: the UK is repeatedly in the bottom third of European countries in terms of respondent’s perception of the role education plays in developing entrepreneurial skills. The study concluded that an American education is still more likely to lead to people leaving school with an enhanced view of entrepreneurs and their role in society.

[4] “Over half of UK SMEs have no plan” *European Venture Capital Journal* 142 pp10-11; May 2007

> "*It's all about universities, we don't have anything comparable to Stanford or MIT in terms of entrepreneurship*" (Interview with an investor)

The majority of secondary schools do not offer standardised business/entrepreneurship curricula or hands-on experience. School offers depend on the demand, on their positioning and on availability of teachers/materials, but students need to be exposed to business and entrepreneurship training and experience as this has a positive effect on their entrepreneurial attitude and expectations. According to the Global Entrepreneurship Monitor (GEM) 2006, adults who receive enterprise education and training earlier in life are twice as likely to think about starting a business compared to those who did not.

The government does invest in advisory services and outreach projects, and the 2007 Budget earmarked £60m per year up until 2011 for enterprise education, however only 4% of graduates are entrepreneurs (Greene and Saridakis, 2007). Indeed, despite government actions aimed at promoting enterprise in education, students do not seem to be learning the skills required to start-up a business.

Starting an enterprise remains one of the least developed abilities during the education path. Although around 70% of students said that they "learned a lot about" Maths and English, less than 20% felt they "learned a lot about" Business, and just 7% about starting an enterprise (Enterprise Insights, 2005). Furthermore, our online survey findings indicate that university education does not prepare students well enough to start their own firm (70.4% of respondents agreed or strongly agreed with this statement). Despite committing an extra £60m a year for enterprise education in schools, the National Endowment for Science Technology and the Arts concludes that "despite these efforts, the number of people thinking about starting a business remains disappointing and has fallen short of the government's target of 14%"(NESTA, 2007).

Our online survey indicates that arranging finance (32.2%), marketing their business (31.6%), understanding specific sector regulations/licenses (22.8%), setting up company administration and record keeping systems (22%), and recruiting employees (19.8%) were the biggest challenges when starting up (on average 12 years ago).

It also shows that the main sources that owners relied on to learn how to manage a company were informal (family or friends) – 23.8%, or belonged to their business network (22.7%).

These findings from our online survey highlight the need for stronger managerial expertise and the importance of business and personal networks in developing these much needed skills. Further evidence of the need for strong managerial capabilities comes from the UK Innovation survey (2005). Besides its technological elements, innovation has a positive impact on value added and market share when it comes from a change in corporate/marketing strategy, organisational structure or from the adoption of advanced management techniques (Table 1). The survey concludes that significant differences appear in the usage level of these wider innovation drivers between smaller and larger companies.

Table 1: Types of wider innovations, % of all enterprises

Forms of wider innovation	Small firms	Medium firms	Large firms	Overall
Corporate strategy	15	23	30	17
Advanced management techniques	12	20	29	14
Organisational structure	15	26	39	17
Marketing	18	26	35	20

Source: UK innovation survey, 2005

Finally, Allinson et al (2006), in a study surrounding the myths about business growth, have recently concluded that "the key unifying feature of the myths is the lack of self-awareness, vision, strategic thinking and management capability among many small business owners". They make further references to the small firms owners' unsupported belief that "benefits of growth are not believed to compensate for this [time spent by owners on management responsibilities], and some businesses discount them almost completely, envisioning the consequences of growth in purely negative terms". The authors also point to owners' inability to think and plan expanding their operating environment, their scattergun sales and marketing practices, and their failure "to recognise or apply relatively straightforward, transferable tools of analysis to manage businesses better, increase profitability and enable growth".

Part of the problem may be their previous education, as Morgan *et al.* (2002) has found that owners/managers of non-growing businesses were more likely to have professional or vocationally-specific qualifications (as opposed to generic or business ones) than managers of growing businesses and so were not necessarily best placed to deal with management tasks.

This strongly indicates the need for further managerial development of entrepreneurs. Intuitively, this can be achieved either through formal training in management and leadership or through informal mentoring and business advice.

3.2.2 Skilled workforce

The UK is losing out in terms of competitiveness in relation to the G7, with lower rates of productivity and a widely perceived skills shortage. The Leitch Review (2005) showed that the productivity rate in the UK is lower than both the US and the G7 average in terms of GDP per worker, GDP per hour worked and GDP per person of working age. This can be further illustrated by the distribution of qualifications profiles: it is a fair assumption that higher education will boost confidence and capability levels, but only 28% of all adults have received higher education (HE), compared to 38% in both the USA and Japan. This is shown by the fact that 1.1% of UK's GDP goes to HE which is up to 40% lower than some of its worldwide competitors (OECD, 2005).

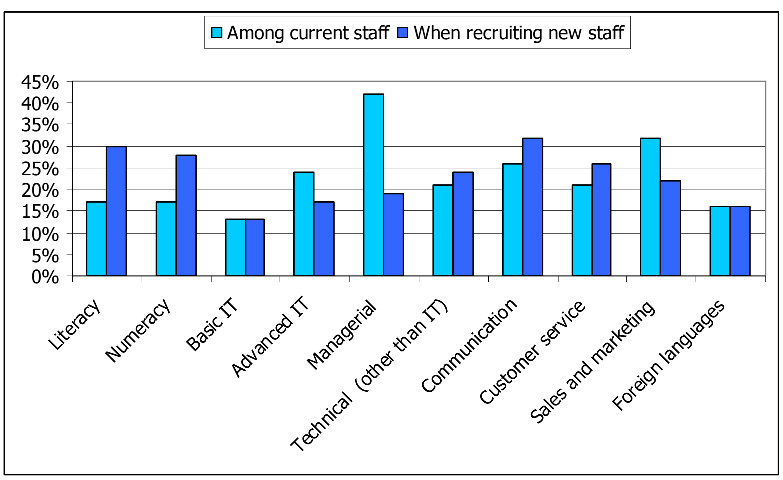
The UK still lacks a solid world-class skills base. Over one third of all adults in the UK still do not have a basic school-leaving qualification and over 5 million people have no qualifications at all. The Leitch Review 2005 emphasised the importance of improving intermediate and high skills as essential to raising the efficiency and innovativeness of the UK labour force.

The output quality of GCSE and A-level exams has been decreasing over the last decade, generating a skills shortage, and attempts to address this problem are failing. One of the main indicators of this trend is the failure of the £386m investment in the Excellence in Cities scheme that was meant to raise the rates of achievement at GCSE levels. Another comes from our online survey, where we asked entrepreneurs to what extent they agreed that GSCE and A levels prepare students for the current labour market – two thirds of our respondents disagreed or strongly disagreed with the statement. 84% also disagreed with the fact that GSCEs and A levels prepare students well enough to start their own firm.

In conjunction with the low quality of English and Math skills at the age of 16, we note an indication from employers that there is a shortage of vocational skills gained in secondary education, which then results in being under prepared to face the labour market. More than a quarter of the employers interviewed as part of the Tenon Forum Survey 2007 highlighted the difficulty to recruit good quality staff due to poor standards of education and inadequate vocational or real life experience. Also, half of SMEs are finding it more difficult to hire skilled staff now than 5 years ago, compared to only 6.5% who find it easier.

Furthermore, our online survey results indicate that employee skills shortages restrict the growth of businesses (Figure 15), particularly in terms of managerial skills (61%), communication skills (58%) and sales and marketing (54%). Particularly relevant is that respondents felt that basic skills, such as literacy, numeracy and communication, were poor among potential recruits, whereas managerial expertise, sales and marketing and advanced IT skills are short among current staff.

Figure 15: Skills shortages restricting business growth



Source: ESCP-EAP team analysis of online survey

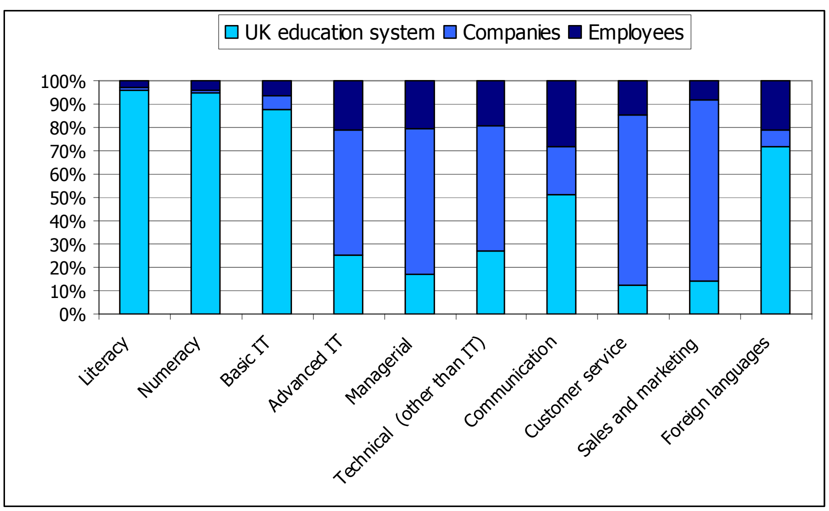
If skill shortages are a significant problem, we would expect to see companies trying to remedy this for themselves without relying on general government policies, and this is indeed the case.

According to a British Chamber of Commerce Report 2007[5], over 80% of businesses surveyed source external training for their employees. Despite this, employers also report a difficulty in providing training to their staff, mainly because of a lack in financial resources or staff to cover employees in training.

The main training providers are much more likely to be independent providers rather than local colleges, therefore "more needs to be done to support colleges in understanding the needs of employers so that they can engage better with them". On the other hand, businesses believe that the Government is responsible to pay for training of employees who have not achieved minimum standards by the time they leave compulsory education and training.

Further insight into this issue is provided by the findings of our online survey. When asked who should be responsible for developing the necessary skills set, respondents indicated that literacy, numeracy, and basic IT skills should be developed by the UK education system, while the development of managerial skills, sales and marketing, customer service and advanced IT skills rests mainly with the companies themselves (Figure 16). Technical skills are thought to be the responsibility of the UK education system and companies, while communication skills should be developed by the UK education system and the employees themselves. These findings confirm the need for the UK education system to enable students to be better prepared for the labour market. At the same time they also confirm the need for companies to provide staff with training in more advanced skills and the government to support firms' training efforts primarily by not subsidising them, but loosening the rules e.g. for students to cover for staff, as interns, while they are away on training.

Figure 16: Responsibilities for developing a skilled workforce



Source: ESCP-EAP team analysis of online survey

One external factor that alleviates the lack of domestic labour supply is immigration, since immigrant workers are an important means to compensate for skills shortages – 34% of

[5] "UK Skills: Making the Grade", British Chambers of Commerce Report, March 2007

businesses that employ foreign workers do so because they "can't get the skills locally", and this is especially evident in industries such as agriculture, mining and fishing. It is also important to note that 74% of the financial and business service organisations that hire foreign workers do so to improve corporate culture, according to a survey by the Tenon Forum in 2006.

We believe that a significant percentage of foreign graduates from top universities migrate to the UK with little intention to remain post graduation; many of them hope to use their education to embark upon entrepreneurial activities in their home country. Offering this segment of the graduate population an appealing alternative may yield benefits to both parties.

> *"The compulsion to check documents such as passports and birth certificates represents an additional pressure on small businesses that don't have dedicated HR support. The expanded set of sanctions set out by the government have to be balanced with clear and accessible advice for businesses if we are to avoid placing an excessive burden on small and medium enterprises."*[6] Kieran O'Keeffe (policy adviser to the British Chambers of Commerce)

3.2.3 Innovation

Innovation is one of the key ingredients to a healthy entrepreneurship environment, as an entrepreneur needs a business/technology opportunity to start a high growth business. Furthermore, innovation is essential for competitiveness and long-term growth of output and productivity. While the UK is widely recognised as being at the forefront of scientific and academic research, it is not doing as well when it comes to the real test of economic innovation – turning scientific discoveries into new products and smart processes.[7]

The IP Awareness Survey 2006 reports that only 19% of firms have invented or developed significantly improved or completely new products/services in the past 5 years, with smaller companies less likely to have been innovative than larger companies. The UK innovation survey (2005) offers a similar picture, showing that only 25% of UK companies have achieved a product/service innovation, and even fewer companies (16%) have innovated process-wise (Table 2).

Furthermore, the OECD Science, Technology and Industry Scoreboard 2007 described UK's innovation performance as "mediocre", drawing attention to UK's low R&D spending and R&D intensity which, incidentally, are below the OECD average. The same comes from the EU Innovation Scoreboard, which ranked the UK as an "innovation follower" in 2006, meaning that they scored lower than innovation leaders such as Sweden, Switzerland, Finland, Denmark, Japan and Germany.

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[6] "UK businesses wary of policing foreign workers", Financial Times, August 7 2007
[7] "The good, the bad and the ugly", The Economist, 2nd of August 2007

Table 2: Types of innovations, 2002 – 2004

Type of innovation	Small companies	Medium companies	Large companies	Overall
Product innovation	23%	33%	39%	25%
Process innovation	14%	21%	31%	16%
Ongoing/ abandoned innovation projects	9%	14%	21%	10%
Innovation-related expenditure	52%	64%	68%	54%
Wider Innovation	30%	45%	58%	33%
Broader Innovation	58%	71%	79%	61%
Innovation active	**55%**	**67%**	**72%**	**57%**

Source: UK innovation survey 2005

A useful indicator of the innovative environment is patent[8] activity, as patents are usually granted for a product or a process that provides a new way of doing something or offers a new technical solution to a problem. Looking at patents is important for several reasons: patents represent the output of R&D activities, which receive substantial financial backing from both businesses and governments. Patents, especially those granted to universities, also encourage technology transfer from universities to businesses and therefore represent another chance for a strong entrepreneurial environment where opportunities abound through patent licensing. However, licensing patents can be complicated and costly, as even though patent owners are willing to license, they are prevented by the associated legal costs. Additionally, smaller businesses and individuals have fewer chances than larger corporations in their attempts to license IP, as large corporations can use their in-house IP knowledge and their bargaining power when completing licensing negotiations, generally leading to a greater success rate.

According to the Intellectual Property Office (2006), the number of patent applications has been slowly decreasing over the last 3 years and only two thirds of applications were made by UK residents (companies or individuals). In terms of patents granted, only 17% of the applications made by UK residents were granted patent status, compared with 31% overall. These figures indicate a low performance of UK-generated innovation.

On the other hand, the last two years have seen a slight increase in patent applications coming from individuals: in 2006, 6,676 patent applications were made by individuals, representing 25% of all applications. This might indicate a respectable level of involvement from individuals who are potentially turning these patents into profitable businesses. However, according to the IP Awareness Survey 2006, "SMEs and the mass of micro-enterprises which form the cradle of IP and future large companies are in the main effectively unaware of the IP system" (p.8). The survey thus identifies IP awareness and the ability of small companies to preserve their intellectual property as key characteristics of fast-growing companies. The data, however, suggests that larger firms do own or create more intellectual property rights than SMEs or

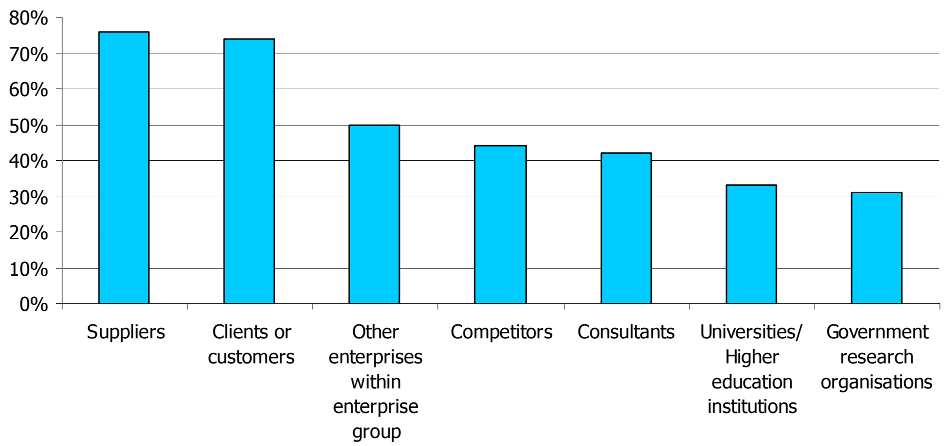
[8] A patent is a set of exclusive rights granted by the state to a person for a fixed period of time (20 years in the UK) in exchange for the public disclosure of certain details of an invention. The exclusive right granted is a negative right that prevents others from making, using, selling, offering to sell or importing the claimed invention (Gowers, 2006).

micro-enterprises. Overall, less than 10% of the companies surveyed own or have created patents, with large companies more likely to own or create patents than smaller companies.

At world wide level, the WIPO World Patent report 2007 indicates that the UK is behind Japan, US, China, Republic of Korea, Australia, and Germany in terms of patent applications, patent grants and patent intensity. The report also mentions that this gap has been widening during the last 10 years.

Universities are major sources of research and innovation and governments have repeatedly tried to encourage university-business collaboration, through technology transfer and innovation clusters (OECD, 2007; Hughes, 2003): in the period 1984-2003, 113 universities had set up technology transfer offices (Lambert Review 2003). However, the UK innovation survey (2005) revealed that universities are among the last partners that enterprises would choose to cooperate with in the interest of innovation. More likely partners proved to be suppliers, customers, and other entities of the enterprise group (Figure 17).

Figure 17: Partners for innovation cooperation



Source: UK Innovation Survey, 2005

Swann (2006) used the UK Innovation Survey data to explore some of the linkages between university research and business innovation. His findings suggest that only a relative small proportion of companies collaborate with universities – under 5%. For those who do collaborate with universities, the effects of innovation (e.g. range/quality of goods and services, market share, value added) are higher than for those who do not collaborate. Swann (2006) concludes that a far higher proportion of those who collaborate with universities find information of value to their innovation activities. This highlights the effectiveness of university-business collaboration, as the UK Innovation Survey found that, overall, universities represent one of the least important direct sources of information (Table 3).

Table 3: Enterprises rating information sources as 'high'

Information source	SMEs	Large companies
Internal		
Within your enterprise group	21	39
Market		
Clients or customers	27	39
Suppliers	15	21
Competitors or other enterprises within your industry	9	18
Consultants, commercial labs or private R&D institutes	3	5
Institutional		
Universities or other HE institutions	2	2
Government or public research institutes	1	2
Other		
Technical, industry or service standards	7	12
Professional and industry associations	5	8
Conferences, trade fairs, exhibitions	5	7
Scientific journals and trade/ technical publications	4	5

Source: UK Innovation Survey, 2005

Internationally, the Lambert Review 2003 notices that UK lags behind the US in its expertise in technology transfer, although the UK is ahead of much of the rest of Europe. The main reason for this difference is that US universities started commercialising their research much earlier than those in the UK, and their relationships with businesses are, therefore, more mature. Moreover, the Review identified a number of barriers to commercialising university IP, among which include the lack of clarity over ownership of IP in research collaborations, too little licensing, and too many unsustainable spinouts.

In summary, we have highlighted the following issues in this section:

- UK education is perceived as much less effective in helping students develop an entrepreneurial attitude, basic business skills and an interest in becoming entrepreneurs
- The UK is losing out in terms of competitiveness in relation to other G7 countries, with lower rates of productivity and a widely perceived skills shortage
- Employers are finding it increasingly difficult to hire skilled staff due to poor standards of education and inadequate vocational or real life experience
- Only 25% of UK companies have achieved a product/service innovation, and even fewer companies (16%) have innovated process-wise
- The number of patents has been slowly decreasing over the last 3 years and the UK is increasingly behind other G7 countries
- The ability of small companies to preserve their intellectual property is a key characteristic of fast-growing companies, but they experience significant barriers to protecting their IP
- Universities, though considered major sources of research and development, are among the last partners that enterprises would choose to cooperate with in the interest of innovation; however their positive effect on business growth and success has been demonstrated

3.3 Regulation

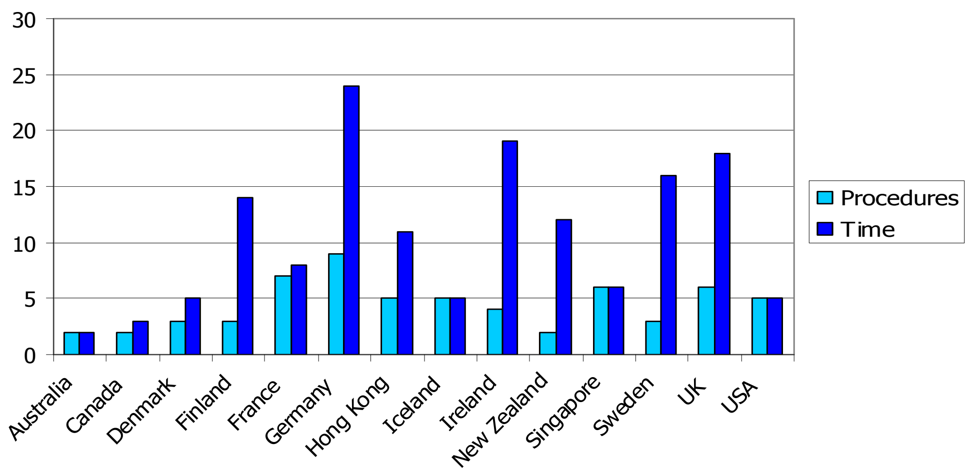
"Regulations are tremendously complex for SME, you have to spend too much time to comply with them" (Interview with an entrepreneur)

Efforts to stimulate entrepreneurial activity tend to focus on the creation of new ventures. We take a broader view of the challenges facing entrepreneurs and investigate the lifetime of a business: at its inception, during the growth phase, and finally at its decline. An economy conducive to entrepreneurship must enable profitable ventures to grow and unprofitable ones to relinquish their capital.

3.3.1 Starting up

Compared to most countries the UK regulatory environment appears, at first glance, to be conducive for enterprise. According to World Bank "Doing Business" Report 2007, the UK ranks 9th in the world for "Easiness to start a business", as starting a business takes on average 18 days and 6 procedures and costs 0.7% of per capita income (Figure 18).

Figure 18: Number of days and number of procedures to start a business



Source: "Doing Business" World Bank database, 2007

However this fails to include the industry-specific regulations that add to the complexity and uncertainty of opening a business. For environmental health reasons a food business must register its premises 28 days prior to opening, and here is a selection of some of the industries that require special licenses before you can trade: auction sale rooms, betting offices, billiard halls, bingo halls, cafes and restaurants, caravan sites, children's nurseries, cinemas, theatres, employment agencies, food manufacturers, fruit machine owners, hairdressers (not always), ice-cream sellers, market stall owners, mobile food shops, nursing agencies, nursing homes, pawnbrokers, pet shops, kennels, selling petrol, riding schools, selling fireworks, selling alcohol, selling tobacco, scrap metal dealers and theatrical employers.[9]

Although the self-employed only need to declare their intention to HM Revenues and Customs[10], setting up a limited liability company takes more. The following activities as necessary:

- Complete 2 forms
- Pay NI contributions (£2.10pw)
- Ensure unique trading name
- Develop accurate terms and conditions (for public website)
- Undertake home insurance to cover business use.

However this underestimates the complexity of starting a company, due to the additional requirements that are likely to be faced by many businesses:

- Register for VAT (£61,000 turnover per year is the current threshold)
- Undertake Public liability insurance (if selling services)
- Obtain planning permission from local council (must display name from place of work)
- Set up bank account.

3.3.2 Barriers to growth

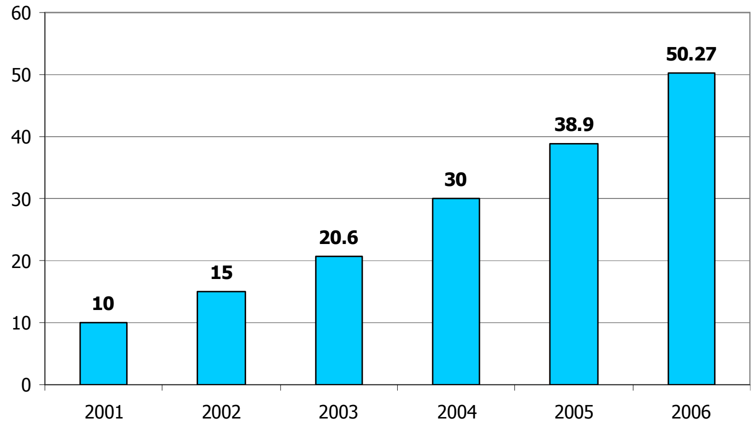
Business owners tend to have a narrow perspective on how growth can be achieved, many of them believing that it is about doing the same business, only on a larger scale. Allinson et al (2006) confirm this assertion in their analysis of myths surrounding growth. Their study also uncovered a related myth: small business owners believe that their business' growth potential is limited by the market it serves and they can not do anything about it. Our online survey findings indicate that regulations are the major obstacle to the success of a small business, followed closely by cashflow and taxation.

Compliance costs begin to seriously burden new companies as soon as they attempt to grow. According to the British Chamber of Commerce Business Barometer 2006, the total cost of the major regulations to business approved since 1998 totals £50.27 billion (Figure 19), and some surveys report that red tape is the largest constraint on the growth of businesses.[11]

> *"The perceived lack of financial support does not seem to have a significant impact on the revealed preference towards self-employment. On the contrary, administrative complexities, also perceived as an obstacle by a large majority of the population, play a significant role in explaining entrepreneurial drive"* (Grilo and Irigoyen, 2006)

[9] http://www.smallbusinessadvice.org.uk/busplan/sulegal.asp
[10] However even self-employment might come up against barriers, in the form of traditional employment contracts.
[11] "A Letter to Gordon Brown", *Start Your Business, 5th July 2007*

Figure 19: Total additional cost of regulation, 2001 – 2006, £ billion



Source: British Chamber of Commerce Business Barometer 2006

Survey data regularly demonstrates that the more employees a small business has, the larger the relative burden, but beyond a certain threshold further growth becomes more cost effective. There is a clear economic logic to this phenomenon, since economies of scale make it possible to spread fixed costs (such as health and safety legislation) across a larger pool of employees. This means that small businesses with many employees face the challenge of catching up in terms of revenues so as to cover labour/administrative costs. According to our survey respondents, the administrative procedures needed to comply with regulations are the largest obstacles.

> "*There are too many problems to fire people, to write reports, if you have just two or three people around, compliance costs are tremendous"*
> (Interview with an entrepreneur)

The volume, complexity, and rate of change of legislation all drew "dissatisfied" or "very dissatisfied" responses from more than half of business owners, in the Small Business Survey, and this dissatisfaction is stronger the more time they have been in business. The complexity of legislation is a source of dissatisfaction for 38% of businesses under a year old, and this steadily rises the longer the businesses have been established (FSB, 2006). Furthermore, more than 90% of our respondents were dissatisfied or very dissatisfied with the volume of legislation, the complexity and interpretation of legislation, rate of change, and cost of compliance with the current legislation. The regulatory aspects, most thought to be an obstacle to the success of their business, were related to the employment law (employment protection, health and safety, anti-discrimination).

This points to an important point about the nature of business development, and the disparity between the costs of starting a business and the costs of growing it. For example, the Small Business Survey 2006 asked small businesses to rate the effect of the following legislative and employment costs: disability discrimination act, flexible working, maternity leave, paternity leave, parental leave and working time. About two-thirds of businesses polled answered "not at all" to the question of whether they had been affected. However it is important to remember that the vast majority of businesses are extremely small, and have low growth ambitions. A more accurate guide to the barriers of enterprise growth comes when the responses are segmented depending on the number of employees: the larger the firm, the more it grows, the larger the barriers (Table 4).

Table 4: Effect of employment legislation by size of firm (%)

	0	1	2-4	5-9	10-49	50-99	100+
Data Description Act							
Not at all/ no response	89.9	90.4	89.9	85.8	80.5	72.5	69.9
Negative	5.6	4.7	5.8	9.1	12.7	16.9	22.2
Positive	4.5	4.9	4.2	5.1	6.8	10.7	7.9
Flexible working							
Not at all/ no response	95.5	97.1	96.1	90.4	80.6	71.6	60.0
Negative	2.4	1.6	2.3	6.7	17.0	21.1	40.0
Positive	2.0	1.4	1.6	2.9	5.4	7.3	0.0
Maternity leave							
Not at all/ no response	93.6	97.9	94.9	84.4	68.3	44.3	33.3
Negative	5.1	1.0	3.7	12.0	24.7	42.3	62.3
Positive	1.2	1.0	1.6	3.6	7.0	13.2	4.3
Paternity leave							
Not at all/ no response	96.0	98.2	96.9	89.9	72.1	52.5	46.9
Negative	3.1	0.9	2.2	8.0	22.6	37.8	48.4
Positive	0.9	0.9	1.0	2.5	5.3	9.5	4.7
Parental leave							
Not at all/ no response	96.5	98.2	96.9	91.6	81.0	65.9	49.2
Negative	2.8	0.9	2.0	6.7	15.7	29.3	47.6
Positive	0.7	0.9	0.7	1.7	3.3	4.8	3.2
Working time							
Not at all/ no response	93.6	95.9	95.3	88.1	75.1	53.3	42.2
Negative	4.5	2.8	3.6	9.2	20.8	38.7	50.7
Positive	1.8	1.3	1.1	2.8	4.1	8.0	7.0

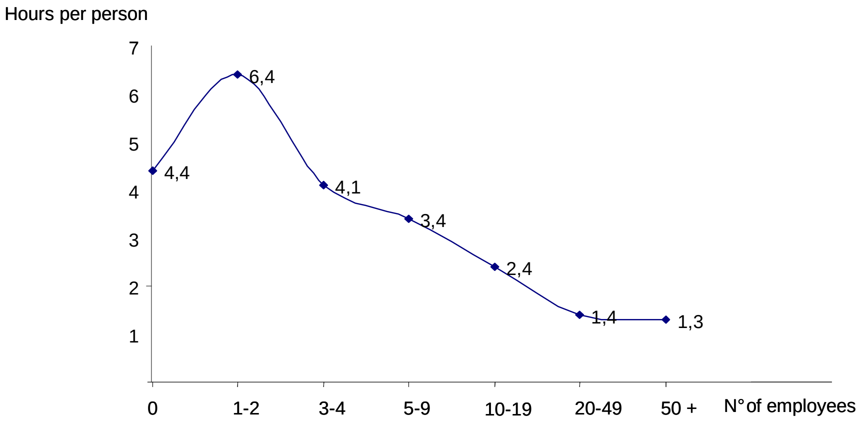
Source: SBS "Barriers" Small Business Survey, 2006

Smaller businesses face greater compliance costs in terms of hours per person, and this is due to the economies of scale involved in larger organisations (Figure 20).

> *"The main hurdle of entrepreneurship is employment law"* (Interview with an association)

We found a great deal of evidence pointing to employment law as a key constraint on growth. Some of the major issues identified were the ubiquity of changes (making it hard to plan) and the fact that SMEs are extremely vulnerable to risks associated with employment law. One of the main difficulties is being able to replace specialist workers that might utilise maternity/paternity leave. Government plans to increase entitlements must be evaluated in this context.

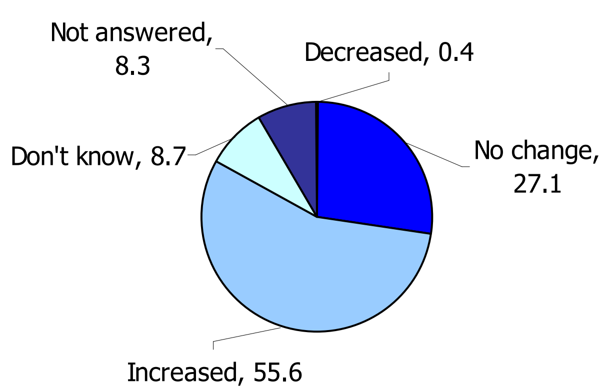
Figure 20: Compliance costs



Source: Tax Regulation and Small Business: a review, SBS

The concept of opportunity cost demonstrates that seemingly benign events can be immensely costly when compared to the next best alternative. Even if it is "free" to comply with legislative hurdles, the time taken to complete them comes at a cost. Although the opportunity cost of spending time on legislation is rarely reported, it costs businesses money. In addition to this, having to spend time on legislation favours larger companies that can afford specialist support. 56% of businesses reported that their time spent on legislation had increased over the previous two years, and this lost time is costly (Figure 21).

Figure 21: Time spent on legislation, %



Source: Barriers 2006, FSB

Another barrier exists when companies attempt to deal with the public sector. According to the results of a Tenon Forum survey 2006, 76% of UK SMEs "feel that the process of applying for public sector contracts is unfair", 85% of those that have applied for a public sector contract find "the odds stacked against them", and this means that just 9.3% of businesses have some type of sector specific standard – often a prerequisite to access public sector markets. The most common reason why it is not the perception is that the process is "too complicated/time consuming".

3.3.3 Barriers to reinvestment

> "*Any successful entrepreneur in the US comes back into the investment ecosystem. It is very easy to find them because they network a lot. They are talking to young companies"* (Philip Wilkinson, business owner[12])

One way to increase the amount of capital available to entrepreneurs is to reduce the costs of removing assets from unproductive uses. A significant proportion of resources are currently being under-utilised, and we advocate measures to put them in the right hands.

As previously mentioned, the barriers to starting to grow a company are relatively low, however it is also important to look at the barriers to close a business and reinvest in another. This is important for two main reasons. Firstly, if it is costly to close a company, fewer people are likely to start one *regardless* of the costs of entry. And secondly, once a company closes, the fluidity of the economy depends upon the ability to reinvest capital into more productive uses. Although on average it only takes 18 days to start a company, it takes a full year to close one[13].

More than 25% of SME owner-managers "might sell their business" in the next few years, but two thirds have no plans to reinvest their capital. Of those that do, only 5% would reinvest the majority of the capital. Our online survey provides similar findings: 8.33% of plan to sell their business in the next two years, and they would re-invest, on average 36% of the profit generated, mainly by themselves.

This is important because reinvestment is a major source of venture capital and, more importantly, provides intangible benefits such as business and management expertise. The largest reason why people close down businesses is due to retirement, but second to this "too many regulations" is the most popular reason why owners wish to downsize, sell, or close their business (FSB, 2006).

Our findings demonstrate that too much attention has been given to the legal obligations required to start a company, and the less obvious barriers that restrict growth or prevent a liquidation have been neglected.

Whilst VAT registration is one of the bottlenecks for starting-up an enterprise, extensive industry interviews and existing evidence suggests that this is not a major hurdle for entrepreneurship. Red tape and bureaucracy as a whole remains the centre of regulatory criticism from enterprises and associations representing them. Decreasing the administrative burden for small firms is crucial; however this must be implemented strategically, focussing on the most critical (in terms of cost/time) and least 'relevant' administrative duties.

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[12] "An Equity gap or a readiness gap?" by Jonathan Moules *Financial Times,* Nov 13th 2006
[13] 'Doing Business' World Bank report 2007

In summary, we highlighted the following issues in this section:

- An economy conducive to entrepreneurship must enable profitable ventures to grow and unprofitable ones to relinquish their capital
- Red tape is frequently reported as the largest constraint on the growth of businesses - the total cost of the major regulations to business approved since 1998 totals £50 billion and is rising
- Time spent on legislation has increased over the previous two years and this lost time is costly, particularly to smaller businesses
- The more employees a small business has, the larger the relative burden, but beyond a certain threshold, further growth becomes more cost effective
- Business owners are increasingly dissatisfied with the volume, complexity and rate of change of legislation, and "too many regulations" is the second most popular reason why owners wish to downsize, sell, or close their business
- Too much attention has been given to the legal obligations required to start a company and the less obvious barriers that restrict the growth or prevent a liquidation have been neglected – as a result it takes a full year to close a business
- More than 25% of small business owners might sell their business in the next few years, but two thirds have no plans to reinvest their capital

3.4 Taxation

The competitiveness of the UK tax system as a whole is failing. We identify four worrying trends that require attention in order for entrepreneurs to face a stable, fair tax environment: the UK is falling behind other parts of Europe; stealth/indirect taxes are mounting; rates faced by SMEs in particular are rising; and tax complexity is becoming unmanageable.

3.4.1 Rising taxes

It is important to realise that *profitability* is the primary means to judge whether a new venture is creating wealth. Therefore, any form of taxation that affects company profits has the potential to undermine socially beneficial entrepreneurship. In the UK there are four main relevant forms of taxation: personal income tax, corporation tax, sales tax (VAT), and capital gains tax. Sales tax is important because it undermines the potential market for products. For capital gains tax the effective rate on gains is currently reduced by taper relief, which increases with time. Personal income tax is highly important for self-employed people because profits are taxed as income. For growing companies, the corporation tax is even more important since it dictates the incentives for extra activity to occur.

Although the UK rate of corporate taxation is not significantly higher than other G7 countries (28% from April 2008), global tax competition is increasing and the UK is losing ground to European neighbours. According to a recent report by KPMG (2007), "The UK seems to be approaching a tipping point. With increasing mobility of staff and capital, and the growing ability of smaller countries such as Luxembourg and Ireland to entice multinational corporations with appealing tax regimes, there is evidence to suggest that the UK is in danger of losing jobs and investment because of its tax laws."

The new members of the European Union have pushed corporate tax rates down sharply from an average of 38% in 1996.[14] A survey of 50 UK-based multinationals conducted by KPMG shows that almost half had considered moving from the UK and 6% were still considering doing so.[15] The taxation levels facing SMEs are even more disturbing, since these are rising (from 19% in 2006 to 22% in 2009).

It is also important to see the full liability of corporate taxation, such as the combined burden of taxes and national insurance contributions. Huggins and Williams (2007) report that "under the Labour government net taxes and national insurance contributions have risen from 34.8% of national income in 1996-97 to 36.3% in 2004-05, and according to Treasury projections will rise to 38.5% of national income in 2008-09, which would be the highest level of taxation since 1984-85". This demonstrates that tax burdens are large and tax rates are rising.

3.4.2 Stealth taxes

In addition to the main forms of taxation, a range of further indirect burdens exists. It is therefore wrong to look at headline rates, without taking a look at extra types of taxation facing the business community. These include:

- customs duty (on goods imported from outside the EU)
- excise duties (taxes on the production of betting, alcohol, tobacco and hydrocarbon oils)
- air passenger duty
- landfill tax (following the 2007 budget the standard rate of landfill tax has been increased to £24 per tonne effective as of 1 April 2007, and it is set to raise to £32 per tonne by April 2008)
- climate change levy (a single-stage sales tax on the supply to businesses and the public sector of some forms of energy which are described as "taxable commodities")
- business rates (chargeable on the occupation of non-domestic property)
- stamp taxes (stamp duty on documents, stamp duty reserve tax on share dealings where

[14] Wikipedia, http://en.wikipedia.org/wiki/Tax_rates_around_the_world
[15] "Global corporate tax rates fall", Financial Times, 23rd July 2007

there is no document, and stamp duty land tax on land transactions).

3.4.3 Tax effects on high growth businesses

Tax compliance also seems to hit new businesses the hardest, and the proportion of new businesses filing their returns on time is lower than for the business population as a whole. The top 10 obligations cost businesses £2.1 billion and half of that has to be supported by business with fewer than 10 employees. The highest administrative burdens come from complying with VAT and personal income tax, as the HMRC requires many forms and returns to be filled in (NAO, 2006). Our online survey indicates that, on average, small companies spend £8,700 and 50 hours annually on complying with tax regulations.

The feeling that SMEs are particularly targeted by the tax man were heightened after an article in the Financial Times revealed that almost 33% of the UK's 700 large corporations paid no corporation tax in 2005-2006, while another 30% paid less than £10 million each[16]. The total tax paid by large public and private corporations was £24.4 billion, meaning that SMEs paid £17 billion in corporation tax in 2006, 41% of total corporation tax revenue[17]. This creates a significant burden on high growth businesses.

The changes to Capital Gains Tax announced in the 2007 Pre-Budget Report will further undermine the attractiveness of the UK as a place to create and grow new businesses. We highlight a growing concern that high growth entrepreneurs are likely to leave the UK to pursue their ambitions. According to KPMG, 86% of finance directors said that a country's tax regime is influential on where to locate operations (a 25% increase compared to last year) and almost half had considered moving their tax residence away from the UK, even before the PBR change. Finally, increased tax rates would force 32% of our respondents to consider relocating their business away from the UK.

> *"Removing entrepreneur-rewarding mechanisms like taper relief may result in an exodus of talent, reducing investment in UK business and having a considerable negative impact on the British economy*" (William Berry, Entrepreneurs Organisation)

3.4.4 Complexity as the main issue

Complexity is another vitally important issue for small businesses. Even well-intentioned tax credits and other attempts to help SMEs, simply add to their overall burden. Business experts and entrepreneurs seem to agree that taxes are becoming increasingly complex, and this is creating a real burden on enterprise. Survey reports suggest that the most recent budget failed to simplify the tax system, and over a third thought it made it more complex (Figure 22).

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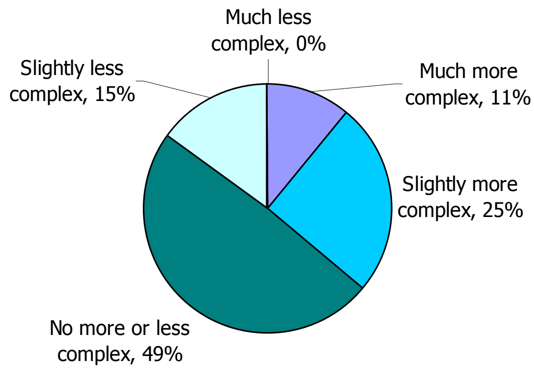
[16] Vanessa Houlder "A third of UK's big business pays no corporation tax" *Financial Times* August 27 2007

[17] "Management of large business Corporation Tax", HM Revenue & Customs, National Audit Office, July 25th 2007

Figure 22: Impact of Budget 2007 on tax complexity



Source: *Forum of Private Business March 2007*

Businesses need to be aware of timing their various tax liabilities, because even when they must register for a number of different taxes simultaneously, HMRC requires them to register for most separately, leading to around 1.2 million registration applications a year (NAO, 2006). According to a survey done by the Tenon Forum in 2006, over 66% of businesses in the UK are unaware of the penalties for incorrect or late filing of tax forms and returns. This results in losses purely due to the complexity of the system.

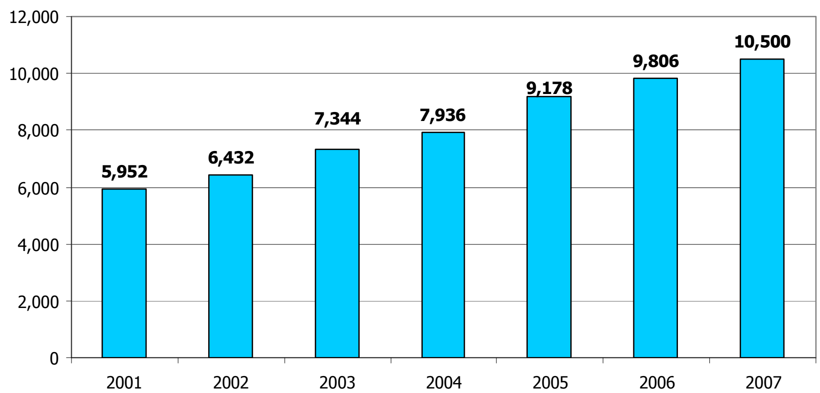
Our online survey findings indicate that 79% of our respondents think the tax system is too complex and that it has a negative impact on their business with regards to the managerial time and attention needed and the money that goes out to tax, money that could be invested in the growth of the business. 85% of our respondents also indicated they have not applied for any tax credits in the last 12 months and 79% believe that radical, structural changes are needed to be made in the UK tax system in order to encourage entrepreneurial activity.

Although tax complexity is a well-known problem, government efforts to resolve it can often back fire by implementing measures that eventually increase the burden. In a survey conducted by the Tenon Forum in 2007, "in view of the HMRC declaring to be committed to reducing the administrative burden that complying with the tax system imposes on smaller businesses" over 50% of businesses reported that they had seen "no difference". In fact, 28% of businesses saw either a small or large *increase* in the administrative burden of tax compliance, compared to just 8% that saw a small/big reduction. The same survey found that the most popular suggestions for changes to the current tax structure were to:

- Use a single tax return to cover all business taxes, e.g. corporation tax, VAT, PAYE (23%)
- Move to a flat rate tax system with a lower headline rate of tax but no special reliefs for things such as capital expenditure (19%)
- Have a single point of contact with HMRC for all business tax affairs (19%)
- Allow dividends to be tax deductible in the business and make them fully taxable for the shareholder (15%).

Finally, the number of pages in "Tolley's Yellow Tax Handbook" is a telling proxy for increasing tax complexity, with the 2007 edition being printed in a smaller print to compensate for the burgeoning content. That content has risen from 5,952 pages in 2001 to almost 10,500 in 2007 (Figure 23) signalling that the only enterprises really benefiting from tax reforms are tax consultants.[18] This increase is partly due to an attempt to explain rules and regulations in more comprehensible terms, but is also a response to tax evasion and loopholes. The government does not seem to appreciate that tax credits are a double-edged sword: the more schemes created to offer support in specific contexts, the greater the need to clarify and enforce the overall tax code.

Figure 23: Number of pages in Tolley's Tax Guide



Source: BBC Online, 2007

In summary, we highlighted the following issues in this section:

- Any form of taxation that affects company profits has the potential to undermine socially beneficial entrepreneurship, and lowering taxes are the most sure route to building a culture of enterprise
- Global tax competition is increasing, and the UK is losing ground to European neighbours. By 2008/09 the combined burden of net tax and National Insurance combinations will hit a 20 year high
- Headline rates of corporation tax mask an increase in other forms of indirect taxation that stifle business growth
- Small businesses are increasingly bearing the brunt, with corporation tax rising from 19% in 2006 to 22% in 2009
- The main problem with taxation is its complexity and even well intentioned tax credits and other attempts to help SMEs, simply add to their overall burden

[18] "Tax guide printed in small print" BBC News online, 6th September 2007

4. POLICY INITIATIVES AND CONCLUSIONS

This section gives preliminary policy guidelines by analysing the barriers outlined in the previous section in light of policy initiatives that have been undertaken in a number of benchmark countries. We previously argued that improving relative rankings should not be the main objective of policy reform, and reiterate that our guidelines intend to improve the UK's entrepreneurial environment independent of international pressures.

Despite a decade of policy initiatives attempting to promote entrepreneurship, "the impact of the Labour government policy on enterprise development appears limited" (Huggins and Williams, 2007). Our criticisms are two fold: firstly, many of the specific policies have failed to meet their stated goals. Secondly, the policies themselves were to some extent misdirected. The main problem seems to be that enterprise policy has been bundled together with social policies (such as regional convergence), blurring economic development with wider redistributive intentions.

As Van Stel et al (2006) argue, policy makers seeking to increase levels of entrepreneurship (often using new firm creation as a proxy) can proceed in a number of ways. The main choice is to either follow a low regulation route or a high support route. The low regulation route focusses policy on two areas. The first is to enable the starting of a business to take place as quickly and cheaply as possible. The second is to minimise the number and severity of regulations on that business whilst it is trading. The US is perceived as the exemplar low regulation country. The alternative policy is for government to provide "support" to new and small firms, funded by the taxpayer. It can be in the form of information, advice, training, or finance to new firms or existing small firms. EU countries have traditionally favoured "support" policies. The two routes are not mutually exclusive and the challenge is to find the best policy mix overall.

We have separated entrepreneurship into two forms of action: the perception of potential profit opportunities, and the subsequent exploitation that result in either profits of loss. It should be clear that policy cannot directly effect the cognitive and cultural environment that generates entrepreneurs with a predisposition for noticing profit opportunities. Rather, these opportunities are a function of the surrounding environment, and therefore policy needs to be directed towards the institutional environment. Entrepreneurial culture and the entrepreneurial environment are not separate functions – they are sequential, but expectations can only rise following the removal of environmental barriers to growth.

We develop a set of policy guidelines that focus on facilitating the desire to grow within companies, many of which fail to even consider this option at the present time due to the regulatory burden of undergoing the growth phase. In doing so, we bear three separate principles in mind. Firstly, the Initiatives are intended to be mutually complementary. This ensures that they stem from a coherent position, and minimise the chances of contradiction. Secondly, we favour broad policy reforms that do not favour specific subsections of the economy. And thirdly, we take a long-term view of institutional reform because entrepreneurial culture takes time to change.

Initiative 1: Increase the transparency of public funds used to increase access to finance

Regardless of the size of the equity gap, we do not feel that public bodies can count on an assumption that public funds are necessary to improve access to finance. In fact, providing public funds for private equity has the potential to actually harm the entrepreneurial environment: by sending mixed signals to entrepreneurs (rewarding grant-seekers rather than profit-seekers); distorting market information (by creating adverse selection amongst external financing); and crowding out private investment. Fortunately there is an obvious way to tell whether a market failure exists. Since any inefficiency is a profit opportunity, if "good" investments are not being made, the funds that plug this gap will make above market returns. Access to finance vehicles such as Enterprise Capital Funds and Regional Venture Capital Funds are run by private fund managers on a commercial basis, and we, therefore, propose that public funds should be invested with transparency, and taxpayers receive annual accounts showing the returns on each portfolio. It is only through knowing the returns of each regional portfolio, that we can identify whether the problem even exists, and can ensure accountability for those managing public money. Over £100m was earmarked for the ECFs in the 2006 budget, and the public expect to see results. This transparency requirement will improve the allocation mechanism of venture capital and insure against the funds being wasted.

Initiative 2: Reduce the compliance costs for business angels who invest as syndicates

> *"Business angels are, in early stage investments, the most important actor. They are the ones that can connect potential high growth entrepreneurs with venture capitalists"* (Interview with a venture capitalist)
>
> *"Instead of investing in regional funds, the government should reduce burdens – 30-40 people attempting to join a network of investors have the same compliance costs of a big venture capital fund, and this discourages people to set up a business angel network"* (Interview with a venture capitalist)
>
> *"Government should reduce the FSA regulations, in particular the requirement for an annual examination"* (Interview with a venture capitalist)

We argue that talk of an equity-gap misidentifies the problem, and the real barriers lie in the burdens that prevent the networks that link entrepreneurs with potential investors becoming even more efficient. We have seen the emergence of market-led solutions, and feel that policy reforms must focus on speeding up this process.

We feel that business angel networks are an incredibly important part of the SME environment, and it is imperative they continue to develop. The number of business angel networks has more than doubled across Europe in the last ten years, with the business angel market in Europe estimated at €1.5 billion[19].

There are a number of alternative investment structures such as: personally investing in a specific deal of your choice; investing in a portfolio of businesses managed by a professional fund manager; or investing in a portfolio of businesses as part of a syndicate of like minded investors. The syndicate route is the most likely way high potential companies can access the amounts of financing they require, and therefore FSA regulations designed to protect unwary investors must be balanced with the need to allow experienced and capable investors from participating as a syndicate.

Evidence from a number of interviews with business angels suggest that the accreditation required for even small pools of investors to provide equity finance can approach the costs faced by larger venture capitalists. We acknowledge the importance of the Financial Services Authority to provide oversight, but welcome ideas such as the self-certification of "sophisticated investors". This enabled investors who met a certain criteria being able to opt out of FSA oversight (and protection), but is simply one step in the direction of freer investment markets. By reducing compliance costs for small investor groups and barriers to become a "sophisticated investor", government will help the creation of networks investing actively in the first stages and in the high growth businesses. This will significantly increase the size of funds available from business angels and provide an injection of capital for high growth companies.

Initiative 3: Market "investment readiness" programmes for entrepreneurs on a broad scale

We have demonstrated that some of the reasons why entrepreneurs have difficulty in obtaining finance for their business are: the poor quality of their business plan, lack of knowledge of the various financial sources and of choosing the most appropriate for their business, and lack of knowledge as to successfully approaching and convincing potential investors.

These problems can be tackled by providing so-called "investment readiness" programmes which can help entrepreneurs strengthen their business plan by improving their financial understanding and ability to analyse the strengths and weaknesses of their business,

[19] EBAN (European Business Angel networks) white paper (2007)

understand the financial sources available to them as well as differences among them, and properly plan and successfully present their ideas to potential investors etc.

In the UK, such a training programme already exists - "Gateway to Investment". The programme targets new companies with high growth potential from technology sectors and is available in London, as it is financed by the London Development Agency in collaboration with private partners. The programme is still quite new and its success is not established yet – it has helped 566 businesses that have created 920 jobs. The program is generally considered very successful in assisting firms to achieve growth (i.e. receive financial backing from private investors). However, the number of jobs created per firm is still quite small. Additionally, it is only available in London. We recommend the programme to be more flexible in adapting to the needs of entrepreneurs and minimise the bureaucracy as much as possible. Another important factor in making this programme more successful is to ensure that entrepreneurs plan to invest the money they would receive in job-creating activities, along with the necessary technology. Finally, the programme needs to be marketed on a wider scale, beyond London, and therefore managing intermediaries and promoting partners are essential.

In any case, the ultimate objective of these programmes should be to increase the number of companies receiving funding from business angels and venture capitalists as a result of greater education and reduction of information asymmetries between investors and entrepreneurs.

Initiative 4: Improve young people's entrepreneurial attitude

We have demonstrated that British individuals (as well as their European counterparts) have a more significant preference for the status of being employed, a more pronounced fear of failure than the Americans, and that these factors have had an impact on their desire and intentions of starting entrepreneurial activities.

What can be seen at pan-European level is a timid attempt to encourage entrepreneurial education and hands-on experience in secondary schools by means of programmes developed and run by two pan-European networks, Junior Achievement Young Enterprise and EUROPEN. These programmes involve setting up real or virtual companies run by students, by drawing up their business plan, raising capital, developing a marketing strategy and trading/interacting with their school or business people from the local community. Most companies last for a school year, and occupy up to five hours a week of students' time, often supplemented by extra time outside normal school hours. The teacher's job is to facilitate the activity and they are often trained by the organisations promoting these programmes. Links with the local business community are a common feature, providing valuable advice and support. These programmes aim at endowing students with the qualities of an "enterprising person", by encouraging them to develop both personal skills and attributes like creativity and public speaking, as well as business-oriented skills such as market research, accounting, and running a meeting.

Such programmes have been run throughout Europe (see "Helping to create an entrepreneurial culture" by the European Commission as a means to draw pan European policies together). However, there are several issues still to be addressed before these programmes achieve their objectives such as: integrating them in school curriculum, obtaining support from both public and local school authorities, training staff and teachers to deliver and supervise these programmes, maintain effective contact with the business community, and obtaining support from the education authorities. Finally, the legal issues involved need to be made clearer with respect to the tax and regulation treatment of these mini companies.

While we have acknowledged these factors are cultural in nature and, therefore, takes time to change, we also believe that instilling an entrepreneurial attitude in young people, by nurturing entrepreneurial values and activities in school (like the mini company programmes), a new generation of individuals will gradually emerge, for whom starting a business would become second nature.

Initiative 5: Improve students' business skills

> *"Education support needs to… offer additional qualifications on the side of traditional academic ones – e.g. accredited industry qualifications that are delivered by the private sector"* (Interview with an association)

We have demonstrated the importance of managerial capabilities and entrepreneurial attitude to influencing the success of new companies. In addition, the Greene and Saridakis report (2007) has found that entrepreneurial skills learnt during higher education do appear to have a long term impact on future entrepreneurial intentions. We also have shown that the current UK education system falls short of inducing students with an entrepreneurial attitude and basic business skills that are needed to start and grow a company.

One possible means of improving this situation is to integrate professional qualifications into the academic education system. Graduates wanting to start a company, no matter the degree they study, should have a basic understanding of marketing, finance, accounting and human resource management. For example, some modules from CIM (Chartered Institute of Marketing), (CMI) Chartered Management Institute, ACCA (Association of Chartered Certified Accountants) and CIPD (Chartered Institute of Personnel and Development) could be integrated into a course on entrepreneurship. 74% of our respondents agreed or strongly agreed with the idea of introducing accounting and other basic business skills in the curricula of secondary school and universities. The main form of evaluation of the course could be that each student designs a realistic business plan for a high growth business.

Another solution could come from colleges and universities inviting successful entrepreneurs to hold lectures on practical problems of their business and the way they solved them.

Successful business people, with sound knowledge and contacts in the industry, could also teach on business/entrepreneurship courses.

Finally, students should be required to gain real world experience and basic workplace skills (potentially by means of frequent internships). In this way, they would have the opportunity to decide if being employed is the best career choice for them as opposed to being self-employed or opening their own business. Furthermore, integrating internships as compulsory activities for each year of university degrees would have two other beneficial effects: one related to SMEs need for training – student interns could cover for the permanent staff that go to training courses; the second is related to entrepreneurs – interns represent an enthusiastic, open-minded and low cost labour force that could help entrepreneurs grow their business at a lower cost.

Even if education better serves the needs of aspiring entrepreneurs, this might be irrelevant if and when they have to deal with civil servants that fail to understand basic commercial acumen. A possible future extension of education schemes might actively involve the civil servants who deal with business people on a daily basis.

If implemented, these ideas would improve the business skills and commercial awareness of students, which will have a positive impact on their professional future, whether that will be to open their own business or to become highly skilled professionals.

Initiative 6: Establish a virtual marketplace for unlisted investment opportunities

We have demonstrated that the major problem regarding access to finance in the UK is not the lack of funds but rather the lack of coordination among the different actors in the SME equity marketplace. The business angel networks are a positive step towards increasing the flow of information and finance between investors and entrepreneurs, as they allow business angels to have access to more potential businesses to invest. However, we believe that much more can be done in order to provide competitive and relevant business projects for the angels.

In this context, we highlight the INTRO marketplace implemented in Finland in 2002 by Sitra, the Finnish Innovation Fund - an independent public fund which under the supervision of the Finnish Parliament promotes the welfare of Finnish society. Sitra has developed the INTRO marketplace to serve as an initial investment platform for Finnish early-stage companies. The marketplace is used by more than 450 business angels and all major funds. The main purpose of the program is to facilitate contact between investors, primarily business angels, and entrepreneurs. This is realised through an online contact forum and an annual tradeshow where young firms and new entrepreneurs can present their business ideas to potential financial backers. In addition to facilitating contact between investors and entrepreneurs, the program can also co-invest with business angels in firms to up to 50% of the total investment.

The marketplace also offers: funding and supporting business idea development, forums for acquiring members to boards of executives, as well as a merger forum for merging sub-critical companies to create stronger start-ups and improve their investment readiness. Nearly 40% of all enterprises introduced at Sitra's INTRO marketplace have managed to secure their initial investment there. The European Commission has invited Sitra to be an expert partner in developing and implementing its EASY programme (Early Stage Investors Action for growth of innovating companies).

We suggest implementing a similar initiative in the UK, possibly through a private – public collaboration. The marketplace environment could be implemented by a private entity, while the Government could offer financial backing (through the participation of its funds) and the operating framework of the marketplace. In addition, we believe that the efficiency of the marketplace could be enhanced if it included many different actors in the private equity market, such as business angels, angel syndicates, in addition to venture capitalists and Government backed funds. This initiative will alleviate the lack of coordination of funds and will extend the pool of funds available for investment and the choice of profitable businesses that business angels can invest.

Initiative 7: Encourage informal mentoring as a means of improving managerial skills

We have highlighted the need for strong managerial skills on the part of entrepreneurs as these skills will enable them to innovate and grow their business. A complementary approach to the one suggested in the previous recommendation is to encourage mentoring as an informal activity of helping entrepreneurs deal with day-to-day issues by former entrepreneurs. This activity is likely to occur naturally when entrepreneurs manage to obtain business angel investment, as business angels are particularly inclined to support business owners with their experience and contacts in addition to their financial backing. However, mentoring should also be available to all entrepreneurs as it would be an effective way of supporting entrepreneurs not only in their daily trials but also in obtaining further finance for their business.

There are several mentoring programmes in the UK (e.g. West Yorkshire Ventures, Mustard.uk.com). However their role is mainly geared towards subsidising and referring entrepreneurs to private consultancy and coaching services. While we praise such initiatives and their role in supporting entrepreneurships in specific regions of the UK, we highlight the importance of informal networks to the development entrepreneurs, in particular of existing or former entrepreneurs who have solid experience of the hurdles that a business owner would have to face everyday in building their business.

In this sense we make reference to SCORE "Counsellors to America's Small Business". SCORE might be seen as the equivalent of Business Link in the UK, however the main difference is that

SCORE benefits from the volunteering of both working and retired executives and business owners, who donate time and expertise as business counsellors.

We suggest implementing a similar scheme in the UK. A preliminary response to this possibility comes from the results of our online survey, where 77% of respondents agreed or strongly agreed they would help new entrepreneurs start a business by mentoring them. We believe that there is an opportunity for experienced directors who wish to take non-executive positions being coupled with new companies that require mentoring. We propose an open-source database for non-executive directors interested in high growth companies with SME owners.

We believe that real life problem-solving experience is invaluable to entrepreneurs in their early growth stage. That is why encouraging mentoring will help entrepreneurs be confident with their managerial role and skills, whilst maintaining the realistic objective of growing their businesses.

Initiative 8: Investigate the success of IP rights enforcement

IP rights are only useful if owners are able to enforce them, whether independently, through the civil courts, or through law enforcement agencies. However, the legal costs of enforcing IP rights can be prohibitive, particularly for small firms as they range between £750,000 and £1.5 million. This leads to very few cases reaching trial stage, as it more often happens that small firms get their IP rights infringed by large corporations but cannot afford to take them to court. This in turn leads to a deficit in patent case law, increasing the general uncertainty around the application of statutes. This finally increases the frustration of small companies who trust the protection that a patent grant should offer them and spend several years in the process of obtaining it.

Given the current decreasing levels of patent applications in the UK and the importance of innovation in successful high growth companies that we have highlighted, some changes are needed in order to encourage certain types of small companies to trust the effectiveness of a patent grant and its ability to protect their innovations. The Gowers Review (2006) has highlighted some of the problems related to the application, granting, use, and enforcement of IP in the UK. However it seems to have mainly focussed on pirated CDs, copyright, and trademarks more than on the concerns of SMEs in terms of using and reinforcing IP rights. Nonetheless, we support some of its recommendations, e.g. the term and scope of protection of IP rights should not be altered retrospectively and that the policy makers should support the action for introducing EU-wide Community Patents[20] and a European Patent Litigation

[20] The key problem at present is that current law treats a European patent granted by the European Patent Office as a collection of national patents all over Europe. A European Patent is therefore often called a "bundle patent," consisting of separate patents valid on a national level. Therefore, legal action in every country becomes necessary when the status of a patent is under legal debate. This can lead to a considerable legal uncertainty in the market, which affects both the parties concerned and the general public.

Agreement[21]. These actions would significantly reduce costs, particularly in terms of translation in other European countries and would make international reinforcement of IP much easier and less controversial.

The Gowers Review suggests that the main problem why businesses don't use the IP system is due to their lack of awareness, whereas we believe that it comes from a belief that a patent is just a piece of paper which not only fails to protect their innovation, but also makes it available to the wider public, and therefore more likely to be copied. Given the large legal costs related to IP enforcement in the UK, we find this attitude justifiable.

In this context, we go further than the Gowers Review and suggest that the costs of dispute resolution should be reduced by greater availability and use of alternative dispute resolution. Also, we suggest removing the so-called "security of costs" as it seems it has developed into a tool that large companies can use in court in order to deter smaller companies from even initiating trial. Finally, we suggest creating and promoting online IP marketplaces where SMEs can showcase their IP offering easily and inexpensively.

These actions will help remove the barriers that small businesses have in using and enforcing their IP rights and therefore encourage more companies to apply for patents and other forms of IP rights, which in turn will lead to more profit opportunities, by means of licensing registered innovations.

Initiative 9: Improve collaboration between businesses and universities

> *"It's really hard for scientists to go from the stage of developing an idea to the market"* (Interview with an entrepreneur)

One of the reasons why the US economy is more conducive to entrepreneurship than the EU is the legal environment that facilitates links between academic institutions and commercial ventures. An aim for future policy in this area should be to facilitate genuine, natural links between higher education establishments and the surrounding business community. As in any relationship, the university-business collaboration has both a demand (businesses asking for research and innovation that they can use commercially) and a supply side (experts channelling their research into commercially valuable IP).

The Lambert Review (2003) was a strong step towards highlighting some of the issues that have been plaguing this relationship, such as lack of business demand for university research, lack of clarity of IP ownership, too little university IP licensing, and too many university spin-outs. It also provided the relevant parties with models of negotiating research agreements which have since been implemented successfully.

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[21] Unfortunately, since the Gowers Review was published, the European Patent Litigation Agreement has encountered severe opposition from the Legal Service of the European Parliament and is believed to "have died".

Nonetheless, there is much room for improvement, as commercialisation activity in many UK universities is still in its infancy: 30% only started their activities since 2000[22]. A comparison with US universities indicates that UK universities are spinning out more companies, but generate less licence income (per unit of research funding). As previously illustrated, it is the rate and quality of growth that is a more important indicator of economic wealth rather than the number of new companies. The final aim of universities should be to help create and sustain viable businesses that create lasting jobs, quality products, and profits that benefit society. In this respect, we highlight an independent American initiative, created by the Kaufman Foundation to establish commercial links between universities and research laboratories with entrepreneurs.

The iBridge Network is an online database with ecommerce capabilities for the dissemination of innovations such as research results and reports, computer software, and other copyrighted works, as well as biological research materials, and patented inventions. There are almost 1,000 research innovations, with the intended adopters being other researchers and entrepreneurial individuals and organisations. Researchers and their institutions post descriptions of their results and inventions on the iBridge Network site and set terms of transfer. Prospective adopters search for and review non-confidential summaries of available innovations, agree to terms of transfer, and arrange for its delivery. It is important to appreciate that it will take time before the UK can expect to see the advantages of the US system. As one interviewee said, "people in universities in the UK only began to develop technologies with a commercial aim in the 1990s. In the United States, this process started in 1955" (Interview with a venture capitalist).

In the UK, we highlight a long standing university-business collaboration initiative, Knowledge Transfer Partnerships (see Appendix 1). This scheme was designed to help mainly small businesses grow and create jobs through bringing together a company with a business problem, a university researcher with a potential solution, and a recently graduated "associate" to perform the knowledge transfer. The associate is employed by the educational institution but works in the company to transfer and embed the knowledge so it will remain accessible if the associate leaves the company, although the associate remains on a permanent position with the company in three out of four cases. Knowledge Transfer Partnerships benefits all parties involved:

- the researcher is able to test their ideas in the real world and keep in touch with developments made in the industry
- the university is able to train the associate in any discipline they might be lacking and forge strong relationships with the company
- the graduate receives more responsibility and authority early in their career and the opportunity of sponsored postgraduate studies

[22] University Commercialisation Survey 2004, Notttingham Business School, UNICO and Auril

- the company gets the input of a bright graduate and the solid knowledge of a researcher, which will help solves their problem and grow their business.

Our online survey provides preliminary response on this topic. On one hand, 63.6% of our respondents indicated they would consider a joint venture with a university that has a good business idea, on the other hand most respondents had not heard of Knowledge Transfer Partnerships and the ones who had did not greatly trust its effectiveness. We believe that this low level of awareness and trust on the part of businesses comes from prejudice and misinformation among small business owners who have either never made use of the service, or used it some time ago and are unaware of changes to the programme, and the focus groups organised by Allinsons et al (2006) confirm out assertion. That's why we suggest this scheme should be further developed and better marketed to small businesses to dispel the myths.

In addition to this, our recommendation is to go beyond current thinking by emphasising that Further Education colleges are often a more appropriate target than traditional universities, since they are already more tied to commercial pressures and thus have stronger links to the surrounding community. Also we do not see universities as being the sole provider of innovations, and acknowledge that often the need is for ideas within small businesses to use the networks and infrastructure of educational institutions.

Finally, we believe that these initiatives will, in the short term, solve the supply side of the university–business relationships by encouraging and promoting university spin-outs and IP ownership/ licensing. In the long-term, they will also have an impact on the demand side of the collaboration, as more businesses will be exposed to university innovation and business expertise and will therefore actively request university research and innovation.

Initiative 10: Simplify taxes

> "*We would welcome announcements on tax simplification*" (Carol Undy, National Chairman of the Federation of Small Businesses)[23]

Tax compliance costs cause harm to all businesses, but they tend to fall more heavily on SMEs because they have to either hire outside professionals (since there are no sufficient economies of scale to hire in-house expertise), or forego the exploitation of loopholes. Overall, governments need to ensure that taxes are as neutral as possible so that fundamental economic considerations, not the tax structure, are the guiding principle in investment, organisational and financial decisions (Hubbard, 1993). That is to say, governments should let the market allocate resources and not the tax system.

What seems to be predominant among OECD countries in this respect is the implementation of a policy that allows small companies to determine their income and expenses on a cash basis

[23] in "Remove the barriers to Growth", Financial Times, Nov 28th 2006

(rather than accruals) – Australia and the US already have this policy in place. Other countries, like Canada and Portugal, have implemented simplified tax regimes for smaller companies. Finally, Italy offers the opportunity to offset tax credits against tax liabilities in a single tax form. This simplifies and speeds up the refund procedure which is more relevant to SMEs.

The Association of Chartered Certified Accountants (ACCA) has also made recommendations in this area. In particular, certain companies are required to produce only a single set of annual accounts and are subjected to a single filing requirement. This means that when they publish accounts for one governmental purpose, this should satisfy all other official regulatory purposes[24]. Also this policy could allow small and medium-sized companies to follow the rules of the future International Financial Reporting Standards for SMEs.

However the danger is that efforts to reduce compliance costs for SMEs simply creates *more* barriers for companies attempting to grow, but the main criteria should be whether costs are rising due to more complex business procedures, or because of arbitrary size thresholds.

Consequently we welcome the ACCA recommendations that focus on streamlining tax compliance for small companies, but would only recommend the introduction of those that would apply across the board. These types of changes will not only drastically reduce the regulatory burden facing SMEs, but will boost their growth prospects by lowering the amount of resources they invest in their taxation obligations. The findings from our online survey support this initiative, as 28% voluntarily mentioned simplification of the tax system as the *one* change they would make if they had the chance, and single filing seems to be the most popular way to improve it.

Initiative 11: Corporation tax is a tax on workers and should be reduced

In a recent working paper US economists claim that "Our data reveal a consistent and large adverse effect of corporate taxation on both investment and entrepreneurship. A 10 percentage point increase in the effective corporate tax rate reduces the investment to GDP ratio by about 2 percentage points" (Djankov et al, 2007).

Corporation tax exploits a popular fallacy that deems a tax on company profits to be more equitable than directly taxing customers, employees, or investors. However companies are merely legal entities and therefore any tax must ultimately fall on individuals (either through higher prices, lower wages, or lower returns on investment). In fact, evidence from the Congressional Budget Office suggests that more than 70% of the burden of corporation tax falls on domestic labour, showing that high corporation tax predominantly results in lower wages.[25] Another research report that looked at data from around 23,000 companies in 10 countries

[24] http://www.accaglobal.com/documents/simplified_business_ec.pdf
[25] See Randolph (2006)

found that "54% of any additional tax is passed on in lower wages, even in the short run; other estimates are larger than this. In the longer run, a $1 rise in the tax liability results in a fall in total employee compensation in excess of $1." (Arulampalam et al, 2007) Corporation tax unambiguously results in lower wages.

Rather than pander to ignorance, we suggest a reduction in corporation tax coupled with a detailed estimation of the expected rise in wage rates.

As previously mentioned, the current regime of corporation tax seems to increasingly target small businesses, and the lower rate that SMEs enjoy is being eroded. Although SMEs with earnings under £300,000 have a special rate of 20% this clearly focuses on helping new businesses survive as opposed to break through growth thresholds. The irony is that superficially helpful policies simply add to uncertainty and create a perverse incentive to remain small.

We actually feel that having a separate rate for SMEs contributed to the barriers for growth, and that parity with larger corporations is in the interests of a stable entrepreneurial environment. Crucially, however, rather than raise SME rates to achieve this parity, we suggest an ambition to reduce the main corporate tax rate over time. Ireland is widely considered to have an excellent environment for entrepreneurs, and their tax environment is a significant factor.

If the state of the public finances will not support a net reduction in business taxes, a reduction in the main rate of corporation tax paid for by reducing and simplifying complex reliefs and allowances would be a good starting point.

Initiative 12: Make reinvestment more attractive and reinstate taper relief

We have noticed a foreboding tendency for people who sell their businesses to call it a day. Overcoming this reluctance is important as relinquishing funds from one company make them available for investment in another.

We have looked at bankruptcy laws to establish a proper balance between ensuring financial responsibility, whilst removing the stigma and ruin caused by failure. International experience seems to advocate for bankruptcy laws that give creditors an important role, both in the process of reforms and in the bankruptcy process, as they have a vested interest in saving viable companies and closing unviable ones. Other important considerations include limiting appeals so that they allow a fast resolution of the bankruptcy process, and allowing companies in financial difficulty to apply for bankruptcy protection before they are insolvent.

Finally, the aim of this initiative must be to facilitate the reinvestment of capital, as this will not only increase the financial funds available to the next generation of entrepreneurs, but also a knowledge base. The easiest way to encourage rollover investment is through the tax system, and as previously mentioned in this report the government's plans to raise capital gains tax (CGT) by 80% could have a significant long term impact. Given that this policy is in place, the best response would be to abandon the proposed changes. This is confirmed by the results of our online survey, where respondents were asked to voluntarily mention one change they would make to the tax structure: 10% suggested reinstating the existing system.

In summary, this paper attempts to contribute to a wider debate on entrepreneurship policy in two ways. Firstly, it provides new empirical evidence that illuminates the importance of high growth companies, and highlights the role of mindset, attitudes, and culture. Secondly we interpret these results to identify significant barriers that prevent entrepreneurs attempting to exploit profitable ventures. If these recommendations are pursued, we feel that the UK can unleash the prime movers of progress, and thus become a genuine global leader in enterprise.

Appendix: Research Methods

The theoretical analysis performed has been supplemented by the creation and utilisation of a range of new forms of evidence. This primary research has been used to uncover the real state of UK enterprise, and validate our policy Initiatives. The main pieces of new evidence are a company growth database, an online survey, industrial interviews; high growth profiling; and focus groups.

Company Growth Database

The main source for this analysis is the Fame database, which contains a population of 2,430,767 active companies in the UK. Our sample consisted of the first 901,800 companies, which were analysed in two ways:

"Time-turnover" analysis

The objective of the "Time-Turnover" (TT) analysis is to understand how long on average it takes for a UK company to grow. To do this we looked at the 7,976 companies that have data regarding the turnover for the last 10 years (1997-2006) and the date of incorporation. This allowed us to perform two sets of analysis. Firstly, direct analysis (static) looked at the companies that reached the turnover threshold during this period, in other words, in one year of the period their turnover was below the threshold and in the following year it went above. This set represents our statistical sub sample for this analysis (100%). We computed the time it took for these companies to reach the turnover threshold and we divided them into classes according to the number of years necessary. Secondly, reverse analysis (dynamic) enabled us to analyse the average size of the companies – in terms of turnover - after 5 years and 10 years from the date of incorporation. We ran this analysis for 4 different years: 1997, 2000, 2003, 2006.

New vs. established companies analysis

The objective of "New vs. established" analysis is to show the different contribution of new vs. established companies for a given year, in terms of: total number of companies; total turnover produced; and total new jobs created. The sample for this analysis was made up of all the companies with data for their 2006 turnover along with the number of employees for 2005 and 2006. We performed this analysis for the last 5 years (2002-2006). Because the total number of records differs from year to year, we used relative values with the total number of the analysed companies (new plus established) in each year being set equal to 100%. To compute the total number of new vs. established companies in a given year, we counted the number of companies founded in the last 36 months (new) and the ones older than 36 months (established). To compute the total turnover produced by the new (established) companies in a given year, we selected all the new (established) companies with the turnover of that year available and calculated the total turnover, considering only positive values. 100% in this case is the total turnover produced by all the analysed companies (new plus established). We defined the number of new jobs created by a single company as the difference between the number of employees in a given year and the number of employees in the previous year. To compute the total number of new jobs created by the new (established) companies in a given year, we selected all the new (established) companies with the number of employees of that year and of the previous one available, that is all the new (established) companies for which we could compute the number of new jobs created in that year. We then summed up all the new jobs created, considering only positive values. 100% in this case is the total number of jobs created by all the analysed companies (new plus established).

The main source for international company data is the Amadeus database, which contains information concerning the top 1.5 million companies in Europe. The limit of this source is that it does not cover smaller and medium sized businesses. We analysed the turnover (in € million) after 5 years from creation, in 2002 (companies founded in 1997) and in 2006 (companies founded in 2001). We compared the UK results to the other G8 European countries (Germany, France, Italy, Russia), Scandinavia (Denmark, Finland, Norway, Sweden) and the EU15 and EU27.

Policy Database

The policy database was generated using several sources of information. For the UK section, we reviewed the major spend of the Government and identified the most expensive initiatives. This was supplemented by extensive desk research into the initiatives of the Regional Development Agencies and their affiliated Business Links. For the international section, the most important sources of information were the reports and articles published by the European Commission, the Kauffman Foundation and the OECD.

Online Survey

The online survey targeted small and medium-sized companies with the aim of validating the barriers previously identified through desk research and industrial interviews. The survey targeted members of several trade associations covering all sectors of business activity. The ESCP-EAP research team prepared an online questionnaire and sent out an invitation to the general managers of the trade associations' member companies. The data was collected online and analysed in strictest confidence using robust statistical tools such as SPSS. 140 respondents participated in the survey, having 12 years of entrepreneurial experience (on average). In addition, 31% declare having revenues only from their business, 23% state they own more than one business and 12% invest in other small businesses. Two thirds have a higher education degree or above. In terms of age, 25% are aged 35 to 44, 34% are aged 45 to 54 and 27% are aged 55 to 64. On average, it took them 7.8 years and 3.7 jobs between leaving full time education and starting a business. Finally, the average turnover of their businesses is £2.8 million, with 58% having a turnover less than £1 million.

Industrial Interviews

We conducted more than 20 interviews with a range of stakeholders including identified entrepreneurs, investors, and associations. These were conducted during August and September 2007 either in person or by telephone, each lasting more than 45 minutes. The research team used a guided interview technique, focussing on specific pre-assigned questions, but allowing interviewees to raise additional ideas. We have not attributed any direct comments, but have collated information to generate broad themes and the identification of specific issues. We conducted 7 interviews with entrepreneurs and focussed on the barriers they face whilst attempting to undertake business activity. These discussions paid particular attention to access to finance, regulations and entrepreneurial culture. We conducted 6 interviews with representatives of venture capital funds and 5 interviews with business angels. These focussed on access to finance and taxation, with a special emphasis on governmental policies and the equity-gap. Also, we conducted 5 interviews with individuals from an array of associations, to provide broader insights focussed on human capital and entrepreneurial culture issues.

High Growth Entrepreneur Profile

In order to generate an insight into the types of personal characteristics that are correlated to entrepreneurs that lead high growth companies, we developed a "high growth profile" database. The primary source was the "Real Business" list of "hot 100 companies"[26] which provides a ranking of the UK's fastest growing private companies over a four-year period up until 2005/6. Our main aim was to profile the founders along the following criteria: name, nationality, age, education, and previous work experience. Out of respect for personal privacy, we sought to exhaust all public information on these issues (such as company data and newspaper articles), supplemented by directly contacting the people in question. We are only reporting non-attributable data for which we have permission to incorporate.

Focus Groups

In order to validate our inquiry into the cultural environment of entrepreneurship, we identified an important group of high potential entrepreneurs and conducted a small focus group. The session lasted for over two hours and three members of the research team were present. Each preliminary initiative was discussed and the attendees also had an opportunity to raise other issues of importance.

[26] See http://www.realbusiness.co.uk

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