EXECUTIVE SUMMARY

LONDON DEVELOPMENT AGENCY

Business Link

Executive Summary of the London Annual Business Survey 2003

December 2003

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Introduction

This research has been commissioned by the London Development Agency (LDA) and Business Link for London. The survey was undertaken in June/July 2003 covering all types of businesses in London with 4,073 firms participating. It is intended that the survey will be repeated on an annual basis.

The objectives of the survey are:

(1) To measure indicators of the competitiveness/productivity of businesses in London and identify the factors that affect this as a basis for assisting in the development of LDA and Business Link for London activities.

(2) To analyse how the physical/social infrastructure of London either enables or acts as a barrier to business competitiveness.

(3) To identify particular problems faced by businesses where they may need further help.

(4) To monitor how these factors are developing over time.

Structure of Businesses in London

London's estimated 300,000 businesses are primarily engaged in service-based activities. Only 13% of businesses are in the Manufacturing and Construction sectors, and this may be an over-estimate as a large proportion of Manufacturing and Construction sector establishments in London are head offices, at which little 'actual' manufacturing takes place. In addition, a significant proportion are publishing companies which are traditionally classified as being in the manufacturing sector.

The majority of London's businesses are small. 47% have less than five employees, 88% less than ten. However, despite there being a large number of small firms, the majority of employment is concentrated in large firms. The London Annual Business Survey shows that:

- London has a high proportion of establishments engaged in group administrative or other strategic activities. 22% are mainly involved in the administration of other operations within their group or division, 4% with strategic sales and 3% are engaged in design.

- 62% of London's firms conduct all their business from a single site. Of the other 38% of firms that are multi-site, a quarter of the sites surveyed act as Head Offices for the wider organisation, and a third had their Head Office located elsewhere in London.

The majority of London's business owners are white and male. Overall, the data suggests that large proportions of the population are under-represented amongst business owners in London. The survey results show that:

- People from Black ethnic groups are generally under-represented amongst London's business owning community. 77% of owners of businesses come from White ethnic groups (White ethnic groups represent 71% of London's population), 3% of businesses are Black owned (compared to a 11% representation in the population as whole), and 12% are Asian owned (which accurately reflects the proportion of Asian ethnic groups in the population).

- Only 21% of business owners are female. 53% of businesses have no female owners and only 7% are owned completely by women. Female owned businesses are more likely to be smaller and to be in specific sectors, particularly Education, Health and Social Work; Other Community, Social and Personal Activities.

- The representation of women owners also varies by ethnic group. The average proportion of women owners is 21% for White owned businesses, 29% for Black owned businesses and 15% for Asian owned businesses.

- 1% of owners of businesses state they suffer from a disability or long term illness.

Turnover, Productivity and Profit

Across UK regions there are strong differences in regional economic prosperity. This is certainly shown in all Government data with London having a higher Gross Value Added[1] per head, household income per head and average earnings than any other UK region. Recently, London has also been growing faster than most other regions.

The UK has had relatively stable macro-economic conditions over past years, with low unemployment, inflation and interest rates. However, the survey took place in general conditions of flattening demand, the war against Iraq, and the outbreak of the SARS virus, together with some specific London factors including the introduction of the congestion charge and the temporary closure of the Central Underground Line. We might expect, therefore, that these conditions are reflected in the results we see on turnover, productivity and profitability. However, the survey data shows that despite these factors:

- 39% of businesses have seen their turnover increase over the last 12 months, with 39% stating that it has stayed the same and 22% that it has declined

- 29% of businesses believed that productivity has increased at their establishment, with 64% stating that it had stayed the same. Only a minority (7%) believed that it had decreased.

- 31% of businesses believed that profitability had increased, whilst 46% thought that it had stayed the same. Just less than a quarter (24%) stated that it had decreased.

- Businesses in some sectors (notably Manufacturing and Publishing) were more likely to state that turnover, productivity and profits were static or declining. Different factors affect different sectors. For example, long term economic restructuring is a key influence on Manufacturing, whilst Publishing, which is heavily dependent on advertising revenues which are currently depressed, is suffering because of the particular stage of the economic cycle.

Over and above size and sector influences on turnover, productivity and profitability there are some other key findings. Firms that have business plans, are foreign-owned and are hi-technology based are more likely to have seen increases in their turnover and productivity.

[1] Gross value added gives an indication of the value of the economic activity generated within an area through the production of new goods and services. It essentially measures the value of goods and services sold minus the costs of inputs.

Although the data is generally positive, there are some findings, particularly relating to productivity, that are of concern:

- there are high proportions (64%) of firms who state that productivity is static. Without constant incremental productivity gains, London's firms will eventually lose ground.

- when asked the main reason for productivity gains (or decreases), the majority of businesses point to the external market, ie they simply increase their output by using existing resources more intensively without necessarily improving the efficiency of underlying processes within the company.

Management issues

Previous research has suggested that UK companies adopt modern management techniques later and less often than their competitors. They also seem to achieve lower returns from implementing them. There is some evidence to support this assertion from the London Annual Business Survey, in that:

- only half of businesses have a business plan

- just over half (51%) have management accounts

- only 42% have a sales and marketing plan.

These planning processes are the basic tools of management and it is of concern that so many London businesses appear to be operating without them. This is particularly so when we consider that there are positive links between the existence of these planning tools and 'success factors', such as an increased likelihood of having increased turnover, productivity and profits. There is a particular concern here amongst smaller establishments – they are unlikely to have any of these planning tools in place.

Comparative data suggests that the UK appears to have a lower level of management skills than other countries. Data from the London Annual Business Survey supports the idea that difficulties in these areas may exist.

- 67% of senior management teams gained their management experience on-the-job with the current company

- 76% do not have a formal management qualification

- 95% of London businesses make no use of non-executive directors.

It appears that there are limited beneficial external influences and knowledge being brought to bear on London's firms that may be damaging their competitiveness.

Workforce issues

Internationally, the UK as a whole compares well on levels of labour force participation, but London has one of the lowest participation rates in the UK and also one of the highest unemployment rates. There is evidence that some sections of the population are more likely to be excluded from the labour market with unemployment rates for minority ethnic groups being higher than for white groups.

This survey is designed to be complementary to the *London Employers Survey*, published earlier this year, and co-sponsored by the LDA and Business Link for London and partners. The *London Employers Survey* shows that:

- Businesses in London are just as likely as those elsewhere in the UK to be facing hard-to-fill vacancies and internal skill shortages. There is no clear evidence that London employers recognise that they face shortages amongst their employees of basic or generic skills.

- But this is not to suggest that London's labour market is the same as elsewhere in the UK. It benefits from a large migrant labour force, which can be part of the formal workforce. There is also a sizeable more 'informal' workforce of young people coming to London from overseas for short durations. Little is formally known about this group, but anecdotal evidence is that they tend to be young and well qualified. London had more low-skill jobs than the rest of the UK in 2001, and there is a hypothesis that these 'informal' and 'formal' workforces go some way to filling the large number of low skill and low pay jobs.

Findings from the London Annual Business Survey also show that:

- 20% of businesses have increased the size of their workforce over the past 12 months, and 30% expect to increase their headcount over the next 12 months

- Smaller firms are most likely to have a stable workforce – as firms get bigger they are more likely to both recruit new employees and/or reduce the size of their workforce

- The vast majority (87%) of firms have increased their workforce to meet a higher demand for products and services, and 10% have recruited to fill skills gaps

- Only 42% of firms have a training plan, with wide variations by sector – ranging from 28% of Manufacturing firms to 67% of Other Community; Social and Personal Activities businesses

- Possession of a training plan appears to be related to higher performance levels. 42% of firms with a training plan have increased turnover compared to 28% of those without. Similarly 30% of firms with a training plan have increased profitability compared to 22% without a plan, and 33% of firms have increased productivity compared to 20% for those firms without.

It is apparent that there is a clear link between possession of a training plan and increased turnover, productivity and profitability. It is also apparent that smaller firms are less likely to have either a training plan, or to actually offer training.

Investment and Access to Finance

UK companies are thought to be operating with lower levels of capital than their competitors in Europe and the United States. Business investment has increased to the level of other advanced economies in the past decade, but this has not been enough to close the gap in terms of capital intensity. However, the survey results are quite positive, showing that:

- London's businesses are spending more in real terms on investment than previously and expect to continue to do so over the next 12 months.

- There is limited support for the commonly held view that there are constraints on investment with 51% stating that they can invest as much as they would like, although 18% did not know.

- The 31% who would have liked to invest more capital in their business have been unable to because of external factors, particularly market conditions.

These findings are not unexpected. The City of London is one of the most competitive financial services clusters in the world. Venture capital availability is the highest in Europe, behind the Netherlands (although there are some concerns about the relatively greater focus on later stage funding rather than seed capital). However, for many firms, particularly small and start-up ones, this is not a realistic form of funding and does not satisfy the needs of such businesses. Certainly data from the *London Employers' Survey* found a greater reliance by companies (and particularly smaller companies) on credit cards and overdrafts as financing sources, which although convenient, are not necessarily the most appropriate forms. Such financing methods are often expensive, which can potentially harm the growth prospects of small and medium-sized firms.

Information and Communication Technology

Information and communications technologies (ICT) are in relatively common use in London businesses, with positive benefits associated with them. However, when firms were asked to describe themselves in terms of their technological adoption, they were relatively cautious.

- Just over a fifth (21%) of London's businesses describe themselves as being hi-tech companies, with a third (34%) believing themselves to be 'lo-tech'.

- On average, two-thirds of staff in London use computers on a day-to-day basis. In over half (55%) of establishments, all staff use computers every day, although in 16% of companies no staff do so. Usage of other ICT is also common with mobile phones being used by 69% of companies and e-mail by 64%.

- These information and communication technologies have had overall positive impacts on companies that have adopted them, particularly on external communications with customers and suppliers. Businesses are less positive about their impacts on 'bottom-line' outcomes such as turnover and productivity, but this may be because they have either not yet seen the impact demonstrated or that the linkage is too diffuse to be recognised.

- Take-up of broadband appears to be accelerating and in this survey 43% of establishments were using it. Where it was being used, broadband was having the most positive impact of any ICT. Although online sales were used by relatively few firms (21%), where they are used, they are regarded as having a very positive impact on the competitiveness of the business.

Overall most firms report beneficial impacts from the adoption of ICT; albeit in terms of communication and efficiency rather than impacts on the bottom line. Going forward it will be interesting to see if firms are able in the future to quantify financially the return on their investments.

Research and Development, Innovation and Collaboration

The creation and commercialisation of new knowledge is a key driver of improving productivity.

In the recent past the UK has invested less public money in research and development than most other advanced economies and, over the last decade, Government expenditure on public research and development relative to GDP has declined. Recent policy changes have started to address this shortfall and the Government budgets for the next few years register a significant increase of public sector spending in this area. It will, however, take some time before the accumulated effect of years of under-investment have been overcome.

There is also a decline in business research and development expenditure. The research and development gap between the UK and its main competitors is increasing and the UK is one of the few advanced economies in which business spending on research and development has actually fallen relative to GDP in the 1990s. The survey shows the following results for innovation in London:

- Within London, 25% of businesses have introduced new products or services in the last year and another 25% have introduced significantly enhanced business practices or processes.

- Looked at together, this suggests that 15% of companies in London are innovative having introduced both: 63% of businesses have introduced neither.

- Businesses are more likely to be innovative if they are larger, foreign-owned, have business plans, are hi-tech, and are located in the Financial Services, Professional Services, Education and Health and Social Work sectors.

- Business collaboration in London is low. Only 16% of firms in London are engaged in collaboration with external partners. Comparative data suggests that this may be low relative to the rest of the UK – some sources put the national figure at 35%. This weak pattern of collaboration may be damaging as collaboration enables companies to broaden their range of experiences and gives them access to a wider range of competences and skills, as well as new markets. Taken together, these factors can help firms gain a competitive edge.

- Where collaboration takes place, it is likely to be with other companies – either customers (47% of collaborative partners) or suppliers (37%). Links between business and Higher Education, although a policy aim for the last two decades, are limited and particularly so amongst smaller establishments.

The results show there is a clear positive relationship between the likelihood of external collaboration and an increase in turnover, productivity and profitability.

Sales and Purchasing

London firms appear to be doing the majority of their business (both buying and selling) within London; presumably because of the density of customers and suppliers within a relatively small geographic area. Improving customer relationships is a key priority for firms, as they see this as their best route to improving competitiveness, but the potential of this aim is probably not being fully achieved as the majority of firms fail to carry out any formal customer satisfaction analysis. The survey shows:

- More than half of London's trade (ie trading relationships with both suppliers and customers) is within London. The majority of trade (about 90% of sales and 95% of purchases) is within the UK. This indicates the importance of London as a business centre, although the fact that a significant amount of this trade is between businesses means the figures may under-represent the importance of international trade. This is because a business may be trading with another business which is selling its products overseas, however, the first business's trade with the second will not be recorded as international trade even though it is clearly dependent on the international market, albeit indirectly.

- 66% of firms have enhanced their relationship with their customers as a means of improving competitiveness, and 45% have implemented an advertising or marketing strategy.

- However, only 25% of businesses formally measure customer satisfaction. This suggests that three quarters have no systematic and direct means of gathering information on their markets or customers. They are operating purely on their own perception of what their customers want This is of concern, as there is evidence that firms who are more formal in their planning processes (which may include customer satisfaction surveys) are more likely to have seen increased turnover over the past 12 months.

London as a Business Location

Only 62% of new businesses started in London are still in existence three years later, which is lower than the national average. The question of course arises whether this reflects inherently higher failure rates or a more dynamic entrepreneurial environment, bearing in mind, on a more positive note, that London does have a very high rate of start-ups.

The London Annual Business Survey shows that:

- The main reasons given for establishing a new company are the desire for the owner to be their own boss, to make more money or to implement a new idea or product. The 'push' factor from unemployment or redundancy does not appear to be an important driver in London, and is certainly less of an issue than data for the rest of the UK would indicate.

- Businesses select the location of their current site because the owner(s) of the business live in or near to London (43% of businesses).

- 39% of businesses chose their current location because their customers/clients are based in London.

- 19% are located in London because it is the central location in the UK.

- Relatively few businesses intend to relocate any of their activities away from their current site despite the fact that London is one of the most expensive places in which to do business.

Barriers and Enablers Affecting Business Competitiveness

There are many influences and factors which give firms their competitive advantage. In London, the survey shows the following:

- Companies consider that the most important factors contributing to competitive advantage are established reputation (59% consider this provides a substantial contribution to their competitiveness), the reliability of service (55%), quality of service (53%) and quality of workforce (52%). Given the lack of formal customer satisfaction assessment highlighted earlier, the fact that firms rely on their established reputation may mean that some firms are vulnerable to changing customer requirements.

- Businesses do not believe that price or cost of products and services are particularly important factors. Whilst the relatively low importance of price competition is encouraging, indicating a propensity to compete on quality, businesses may be missing opportunities to put downward pressures on costs.

- As well as building stronger client relationships and devising advertising/marketing strategies as previously mentioned, 41% of firms have adopted IT as a way of improving competitiveness, 24% have cut production costs and 22% have diversified or launched new products in different sectors.

- Businesses say that the key factor in the successful running of the business is the availability of skilled labour, followed by the cost of this labour.

- Following these labour-related factors, premises (cost and size) and then proximity to customers are the key issues for the successful running of a business in London. Relatively speaking, proximity to suppliers or other businesses in the same sector are seen as being less important.

- The survey also asked about the extent to which these factors represent a problem to the successful running of businesses. Labour-related and premises-related issues were the most often cited problem areas, followed by transport issues. Proximity to customers is seen as important for the running of businesses but is not seen as a particular problem area in London.

Business Information and Advice

There has been a long tradition of both publicly and privately supported business advice provision in London, currently:

- 57% of firms have used business advice services over the past 3 years. This is encouraging, especially given the range of issues and potential problems facing businesses previously highlighted.

- The most commonly used sources are accountants (43%), banks (34%), trade associations (9%) and Business Link for London (8%).

- Small firms are more likely to use external business advice services, as are UK-owned and hi-tech businesses, firms in Central, West and North London, and those in the Publishing, Financial Services and Professional Services sectors.

The top four providers in terms of customer satisfaction are accountants, who have a mean score of 4.13 out of a possible 5, business consultancies (4.01), chambers of commerce (3.99) and Business Link for London (3.88).

The main advice sources are accountants and banks. This is to be expected as the vast majority of businesses will have an on-going relationship with these two types of organisation. Satisfaction with advice sources used is generally high.

Discussion and Conclusions

Overall Performance

London's economy is of overwhelming importance to the UK as it has the highest regional Gross Value Added per head of population, and the highest levels of average income and income per household. It is primarily a service sector based market, which is continuing to grow. Perhaps because of this concentration in growth sectors, firms in London are prospering – 39% have seen an increase in turnover over the past 12 months.

The economy is dominated by microfirms – ie firms with less than 10 staff – although the majority of employment is actually in larger firms. The majority of firms also have very low turnover; only 10% have a turnover of more than £1million, and 44.5% have a turnover of less than £100,000.

However, to maintain current levels of prosperity, overcome skills gaps and compete successfully given the high cost base of being located in London, there are 4 key challenges facing businesses in the capital:

Priority – Productivity

Being able to operate effectively and efficiently is a key tool to improving competitiveness, at all levels, and as such is a major concern for both policymakers and practitioners. The survey evidence shows that 29% of firms in London think that they have increased productivity over the past 12 months. However, the main reason given for the positive change in productivity is to meet increased demand for products and services, ie they simply increase their output by using existing resources more intensively. There is relatively little evidence that firms have improved their underlying efficiency - using their existing resources and assets more effectively and improving the efficiency of underlying processes within the company - although 10% report that increased use of IT has helped. Equally worryingly, there is a sizeable proportion of the business population (69%) who report that their staff productivity has stayed the same. This means that London could be failing to optimise its competitive capabilities.

There is a clear need to track this performance level over time and to investigate in more depth just how firms are realising productivity gains. Encouraging more firms to become more productive is also a key priority.

Priority – Innovation

The creation and commercialisation of new knowledge and ideas is a crucial source of improvements in productivity and competitiveness, particularly in the emerging knowledge economy.

According to national statistics, London has relatively low levels of spend on research and development; which can be one component of spend on innovation. The London Annual Business Survey appears to support this view. It has also discovered that only 25% of firms have introduced new products or services within the last year, and another 25% have introduced new business processes. We call both these groups Changers. Just 15% of firms have implemented both sets of innovation activities, and can be truly classified as Innovators. More worryingly almost two thirds (63%) have done neither, these are classified as Conservatives.

The London Annual Business Survey shows there is a clear positive link between the propensity to be innovative and the likelihood of an increase in turnover. The overall message is that more firms need to be encouraged to become innovative. Once again, by tracking this performance over time it will be possible to see the extent to which this aim has been achieved.

Priority – Management

One of the key conditions which needs to be present in a business to allow both innovation and productivity to flourish, is a competent management structure and associated processes.

The London Annual Business Survey highlights significant gaps in these areas. Significant proportions of the business population lack rudimentary business planning processes – 50% do not have a business plan, 58% do not have a sales and marketing plan, 79% do not have monthly management accounts, and only 25% of businesses formally measure customer satisfaction. These are basic management tools, and their absence across large proportions of the business community suggests, at best, that they are being run on an 'ad hoc' basis.

This lack of business planning is likely to be even more damaging to the competitiveness of firms in London when we consider that effective planning tools are positively correlated with increased turnover, productivity, size of the workforce expenditure on product and service development and the propensity to be innovative.

The challenge here is to effectively reach the large and diverse marketplace, which is primarily made up of microfirms, and to encourage more firms to adopt good management tools and processes.

Priority – Business Information and Advice

In the light of the challenges relating to productivity, innovation and management capabilities it is clearly apparent that there is still a key role for the provision of advice, support and networking to businesses in London. Although 57% of firms have used external advice during the past 3 years, 43% have not. When we consider that the majority (67%) of managers in London have acquired their skills on-the-job within their current firm, and less than one quarter (24%) have formal management qualifications, there are evident grounds for concern that firms are not benefiting as much as they could from external influences – including the wide variety of external business support.

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