



Management Matters

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Business Stay-Up

THE ENTREPRENEURS NETWORK IS A THINK TANK FOR THE AMBITIOUS OWNERS OF BRITAIN'S FASTEST GROWING BUSINESSES AND ASPIRATIONAL ENTREPRENEURS.

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“The research method underpinning the Business Stay-Up campaign focuses on small firm growth and job creation as hard indicators of entrepreneurial success.”

ROB MAY
Chief Executive Officer, Association of Business Executives

FOREWORD

Policymakers worldwide are focusing on start-ups as an engine of long-lasting economic growth and have set about creating the right conditions to facilitate entrepreneurship. The start-up agenda has empowered many and continues to gather momentum. In 2016, the UK registered the equivalent of 70 new businesses per hour.



ROB MAY

Chief Executive Officer, Association of Business Executives ABE is an education non-profit, operating globally to improve business and entrepreneurial skills.

However, this record rate of business start-up creation does not reflect the goal of entrepreneurship policy, neither is it a helpful indicator of wealth creation. Downstream as many as 56% of these new businesses collapse within 5 years. Therefore, we could question the level of impact that start-ups have on long-term productivity and employment. The Business Stay-Up campaign was established to explore what could be done to promote entrepreneurial quality, as well as quantity.

Of course, in an efficient economy not every business can or should flourish, some are simply outcompeted, and we are not attempting to prevent all businesses from failing. But this report shows that improving small firm engagement in business education, and management skills specifically, is a policy lever which can definitely support those businesses at the margin.

Small business owners are usually passionate enthusiasts with great ideas and strong intentions to turn their dream into a start-up success. But many on that roller coaster entrepreneurial journey find that they are attempting to lead and grow their enterprise without basic business skills or knowledge, and many assume that business acumen is a minor part of the entrepreneurship equation. Such an approach is unlikely to survive contact with reality.

This report also highlights unresolved challenges around the perception and accessibility of business education. For instance, an analysis of OECD data finds that UK business owners are lagging behind their contemporaries in 17 other countries when it comes to engaging in adult education and training.

The research method underpinning the Business Stay-Up campaign focuses on small firm growth and job creation as hard indicators of entrepreneurial success and reveals new evidence to clearly demonstrate the importance of business education on raising the probability of small firm survival.

The report recommends some practical policy developments to incentivise educational interventions in the entrepreneurial journey. Bold and decisive 'policy entrepreneurship' is now required to help small business owners equip themselves with the management skills needed to confront an array of huge and growing competitive challenges, and to help more business start-ups to stay-up.

INTRODUCTION: QUALITY AND QUANTITY

There is an argument to be made that the UK has the wrong attitude to failure. Too often unsuccessful entrepreneurs are written-off by funders, journalists, and worst of all – themselves. That’s often a mistake – evidence suggests that entrepreneurs do better the second time around.¹ Samuel Beckett’s words “Ever tried. Ever failed. No matter. Try again. Fail again. Fail better.” are rightly lauded by Silicon Valley.² As a society, we all benefit from the risk-takers who accept a high probability of failure to bring innovative products and services to market.

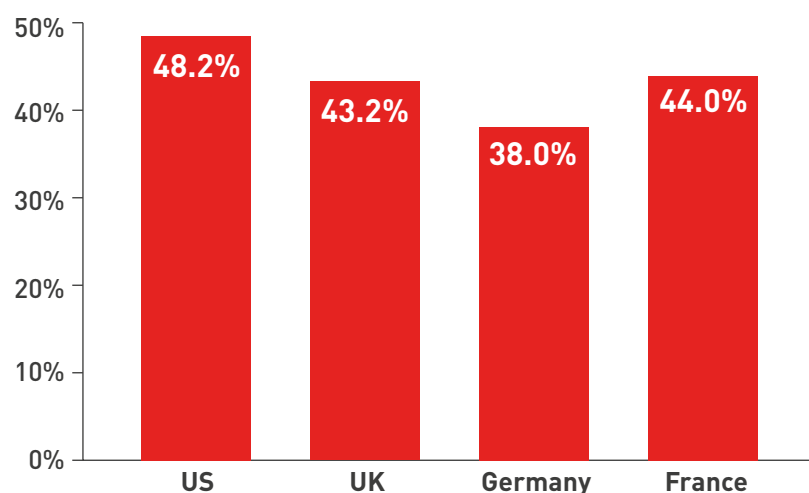
But we shouldn’t fetishise failure. We may learn from our mistakes but as Peter Thiel (Founder of PayPal, Palantir, and Founders Fund) points out: “Most businesses fail for more than one reason... You will think it failed for Reason 1, but it failed for Reasons 1 through 5. And so the next business you start will fail for Reason 2, and then for 3 and so on.” Failure can sap ambition too, society can lose out if future ventures are less ambitious. It goes without saying that business failure is almost always a personal tragedy.

Still, in a dynamic market economy failure will be a fact of life. Over half of small business owners list competition as a major obstacle to the success of their business.³ By its very nature competition has winners and losers. When more efficient businesses take market share from inefficient incumbents by delivering better products at lower prices, it should be a cause for celebration.

We should welcome Britain’s record rate of new business creation (657,790 new companies were founded in 2016).⁴ It is right to toast more Britons embracing an entrepreneurial mindset, but entrepreneurship isn’t an end in itself. The focus ought to be on quality – innovation, growth, employment -

not quantity. On that front, Britain is doing well. The UK is home to 35% of Europe’s tech unicorns (companies with a \$1bn valuation) and has pulled in three times more venture-capital than any other European nation since 2016.⁵

CHART 1: 5YR SURVIVAL RATE - UK, US, GERMANY, FRANCE



Sources: Small Business Administration, ONS Business Demography, Eurostat

1 Lafontaine, F., & Shaw, K. (2016). “Serial entrepreneurship: Learning by doing?” *Journal of Labor Economics*, 34(S2), S217-S254.

2 The same ethos is also expressed by “Fail fast, fail often” and Facebook’s old motto “Move Fast and Break Things”.

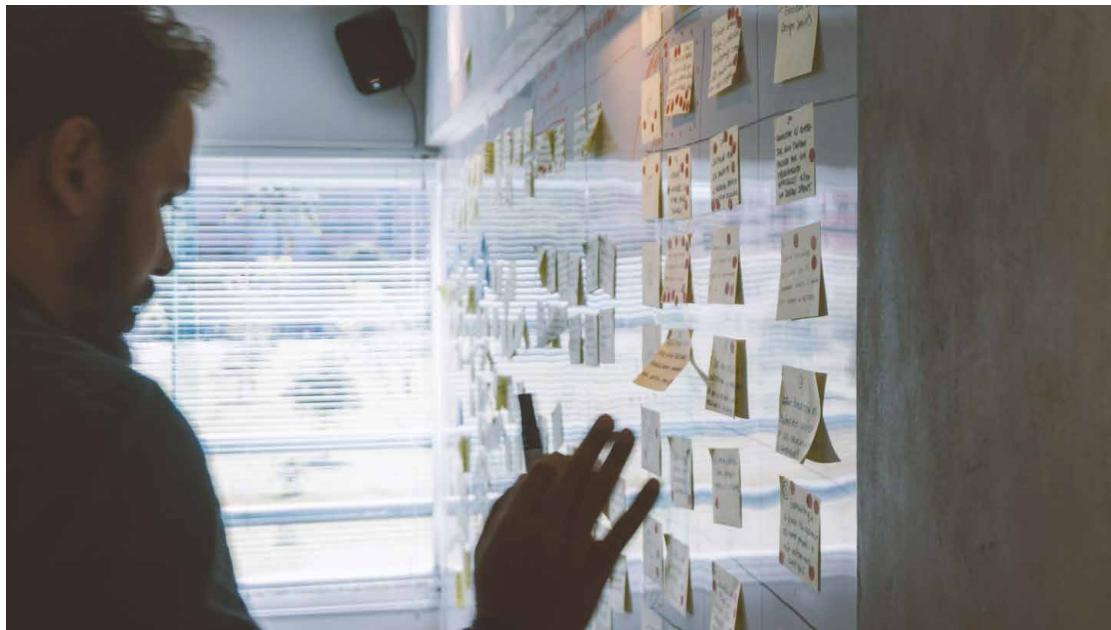
3 Longitudinal Small Business Survey 2017: SME Employers (Businesses with 1-249 Employees, Department for Business, Energy, and Industrial Strategy).

4 Bounds, A. (2017) “Number of UK start-ups rises to new record.” *The Financial Times*

5 London and Partners (2018) “UK and London remain top European hubs for global tech investors”

“Failure is massively overrated.”

PETER THIEL
Entrepreneur and
Venture Capitalist



But not all firms succeed. In the UK, 56.8% of new businesses will close within their first five years.⁶ We are not outliers either. Across the EU five-year survival rates hover around 50%, while the rate in the US is 48.2%.⁷

We should look at survival and failure rates carefully. A high failure rate may reflect a difficult business environment, but it could also signal a willingness to start and invest in riskier ventures. For instance, research from Prof Mark Hart at Aston University found that London has the lowest rate of start-up survival in the UK, but it also has the highest rate of high-growth entrepreneurship.⁸ Paradoxically, failure rates may be highest in the environments most conducive to quality entrepreneurship.

Necessary and unnecessary business failure

Businesses can fail for many reasons. Paul Graham, founder of Y-Combinator, listed 18 different reasons for start-ups failing.⁹ They range from bad hiring practices to failing to focus on what consumers want. We ought to distinguish between necessary and unnecessary business failure. No business has an innate right to exist. Some ideas simply don't pass the market test. Google-backed Juicero failed because there simply wasn't a market for a \$399 wi-fi enabled juicer.

Other times new ideas succeeding entails old ideas failing. Consumers won out when Netflix provided a more

convenient alternative to Blockbuster (ceased trading in 2013), when Apple and Samsung displaced Kodak (filed for bankruptcy in 2012) by making high-quality digital cameras a standard feature for smartphones, and when Amazon's low-prices and fast-delivery led to Maplins, Woolworths, and Toys R Us shutting down. In most cases, any jobs lost were eventually replaced with better-paying higher productivity work.¹⁰

Attempts to shield firms from competitive forces either by creating barriers to entry or by tilting the tax system in favour of struggling incumbents should be avoided. This prevents good practices from diffusing, locks-up capital in inefficient companies, and ultimately leads to ordinary consumers paying more.

But not all business failures are necessary. Too often viable businesses fail due to poor managerial practices. From *Troubleshooter* and *Alex Polizzi: The Fixer* to *Ramsay's Kitchen Nightmares* and *Mary Queen of Shops*, there is a cottage industry of reality TV shows where experienced business people turnaround struggling small businesses. The advice given is often simple and formulaic, but provided the business owner is willing to listen, it often works.

There's no better example of the phenomena than CNBC's *The Profit*. In the show, Camping World CEO Marcus

6 Business Demography, Office for National Statistics.

7 Survival Rates and Firm Age, Small Business Administration

8 Bounds, A. (2017) "London start-ups are most likely to fail." *The Financial Times*

9 Graham, Paul. (2006) "The 18 mistakes that kill startups." *Paul Graham*.

10 Mandel, M. (2017). *How Ecommerce Creates Jobs and Reduces Income Inequality*. Progressive Policy Institute, Washington, DC.

Lemonis buys stakes in promising, but failing, small- and medium-sized enterprises and returns them to profitability. Unlike other shows, Lemonis only targets firms with sound underlying business models. The companies he takes over typically grew rapidly after an unexpected hit, but are now struggling to control costs. Each episode follows a predictable formula, he runs the numbers to work out which products are the best-sellers and which have the highest price-to-cost margins. Lemonis then shifts production to the highest-margin best-sellers, re-organises the shop floor and implements a simple inventory management system to reduce costs. In many episodes, he also resolves personal issues between sometimes-related staff members.¹¹

Lemonis' simple methods deliver impressive results. Sweet Pete's, a sweet shop that Lemonis turned around grew from 5 to 90 employees and increased its revenue by more than tenfold. While Mr Green Tea, an ice cream company he invested in, has trebled its \$2.5m valuation.

There is a growing body of evidence linking productivity to the uptake of the managerial best practices espoused by Lemonis. Good managerial practice predicts a firm's success better than R&D spending, IT spending or how skilled their workforce is.¹² In fact, whether or not firms consistently monitor and improve their processes, set and revise targets, and incentivise employees through merit-based hiring, firing, and promotion procedures explains almost a third of the differences in productivity between and within countries.¹³ Put simply, when businesses are well-managed they create more jobs, pay higher wages, and sell better (and cheaper) products.

Better advice and training can help businesses survive and we should all want this. It makes sense – both morally and economically – to want as many business owners as possible to have the skills to give it their best shot. Fewer unnecessary failures will create a more competitive business environment, which will drive further improvements in efficiency and innovation benefitting society as a whole.

The Business Stay-Up Campaign

Business Stay-Up is a research-led campaign to promote high-quality entrepreneurship by drawing attention to the importance of skills and management to helping British businesses survive and scale. As part of the campaign, the Centre for Education Economics (CfEE) has published *Human Capital and Business Stay-Up: the relationship*

between education, skills and entrepreneurial success by Gabriel Heller Sahlgren. The report revealed a strong link between business owners' area of specialist study and high-quality entrepreneurship. Perhaps unsurprisingly, training obtained through programmes in business, social science, and law, and in technical areas, such as engineering, are linked to entrepreneurs employing more people, while other areas of study are not. In particular, Heller Sahlgren finds that programmes that offer task-related training do best. Entrepreneurs need to both learn best-practice management techniques and keep up-to-date with the latest developments in the industry in which they operate.

“Fewer unnecessary failures will create a more competitive business environment, which will drive further improvements in efficiency and innovation benefitting society as a whole.”

Heller Sahlgren's research highlights the need to investigate further both, which management training programmes deliver the highest impact, and which policy levers are most effective at improving managerial quality across the economy. The CfEE's report recommends that the government funds randomised trials to identify the most promising approaches to training and expands access and uptake through targeted tax breaks.

In this report, we will set out the evidence on the link between management skills and firm success, highlight schemes already up and running that promote high-quality entrepreneurship, and build upon CfEE's research to set out a policy agenda to equip Britain's small and medium-sized enterprises with the advice, training, and environment to survive and scale.

11 Tabarrok, A. (2018). "Lessons from the Profit" *Marginal Revolution*

12 Bloom, N., Van Reenen, J. and Brynjolfsson, E. (2017) "Good Management Predicts a Firm's Success Better Than IT, R&D, or Even Employee Skills." *Harvard Business Review*

13 Bloom, N., Sadun, R., & Van Reenen, J. (2016). "Management as a technology?" Working Paper 16-133, *Harvard Business School*





MANAGEMENT MATTERS

The first economist to spot the link between management and productivity was Adam Smith. His famous study of a pin factory highlighted how through better organisation and specialisation the average worker could become 50 times more productive. But while economists have long recognised the importance of management and countless business books have analysed case studies of visionary managers and corporate leaders, only recently have economists begun empirically quantifying the impact of managerial quality on productivity, employment and output.

Alexopoulos and Tombe find that organisational innovations such as Taylor's Scientific Management, Motorola's Six Sigma (popularised by GE's Jack Welch), and Agile Software Development increased productivity and aggregate output by almost as much as technological innovations.¹⁴ Yet often good management practices diffuse too slowly. There is a growing concern that a divide between 'superstar' firms pushing forward at the technological and organisational frontier and a long tail of firms lagging behind is leading to increasing inequality and sluggish productivity.¹⁵

The long tail

Chad Syverson finds that within a typical US industry the most productive tenth produce almost twice as much as the least productive tenth with the same inputs.¹⁶ The situation is even more extreme in the UK. In a 2017 speech, the Bank of England's Chief Economist Andy Haldane noted that the gap between our highest and lowest productivity firms was larger than in the US, France or Germany. In particular, he drew attention to the fact that "In the services sector, the gap between the top- and bottom-performing 10% of

14 Alexopoulos, M, and Tombe, T. "Management matters." *Journal of Monetary Economics* 59.3 (2012): 269-285.

15 Autor, D., Dorn, D., Katz, L. F., Patterson, C., & Van Reenen, J. (2017). "The Fall of the Labor Share and the Rise of Superstar Firms." IZA DP No. 10756

16 Syverson, C. (2011). "What determines productivity?" *Journal of Economic literature*, 49(2), 326-65.



companies is 80% larger in the UK than in our international competitors". Haldane argues that Britain's productivity issues can be attributed to a failure of firms in the long tail to adopt the practices and processes of Britain's highest achieving firms.¹⁷

The chart below shows that the UK has a significantly larger tail of poorly managed firms when compared with Germany and the US. Bloom, Van Reenen and Sadun find

that management explains 29% of the difference between the top and bottom performing 10% of companies in the UK. Improving the management skills of the UK's marginal businesses would have a massive impact on productivity; Haldane estimates that closing the productivity gap between the top and bottom three quartiles would boost UK GDP by £270bn. This is especially significant in the context of a historic pay squeeze driven by sluggish productivity growth.¹⁸

CHART 2: UK, US AND GERMAN DISTRIBUTION OF MANAGEMENT SCORES



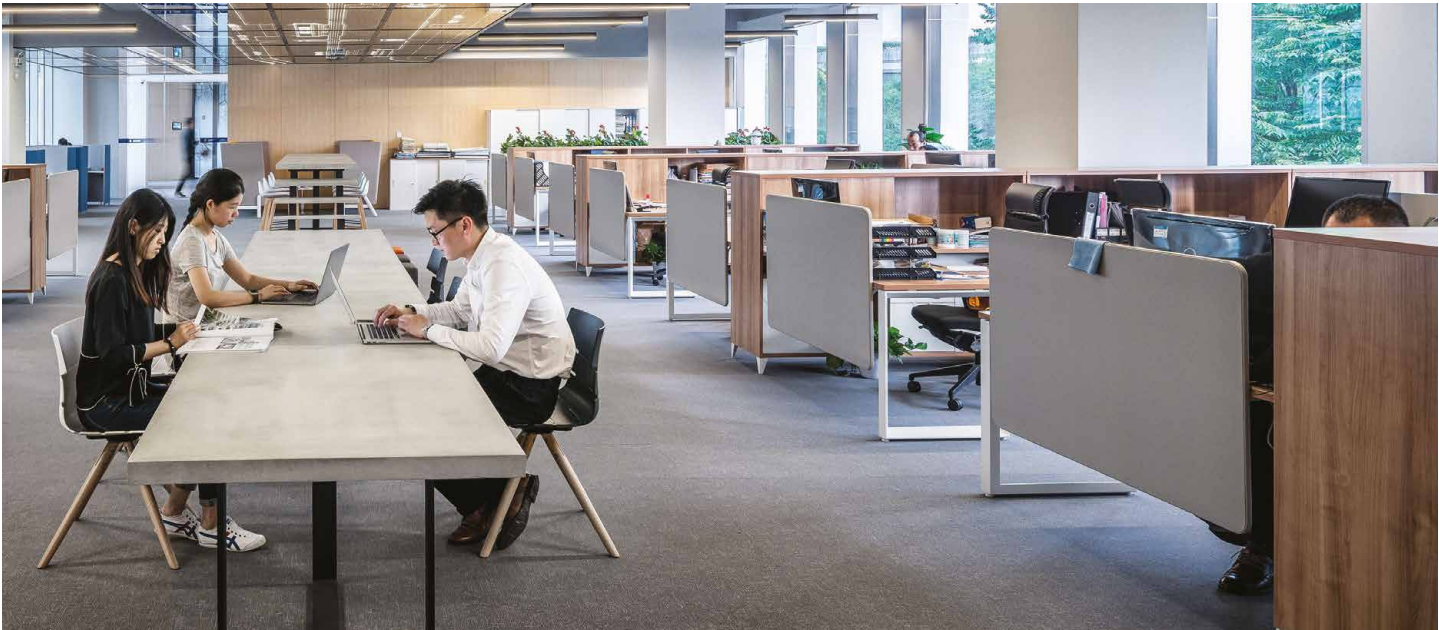
Sources: Bank of England calculations.

17 Haldane, A. (2018) The UK's Productivity Problem: Hub No Spokes. Academy of Social Sciences Annual Lecture.
 18 Clarke, S. and Gregg, P. *Count the pennies: Explaining a decade of lost pay growth*, The Resolution Foundation.



“There is strong evidence that the adoption of multiple measurable techniques leads to higher output.”





What makes a good manager?

Taking a step back for a moment, it may sound strange that we can measure and compare two firms and say one is better-managed than another objectively. There are two competing perspectives on management. One sees good management as contingent and firm-specific. On this view, good management at Apple could be counter-productive management at Sports Direct. There may also be cross-cultural differences in management effectiveness, what works for a Japanese firm might not work for a British firm. An alternative view sees management as a form of technology. As managers adopt better techniques they become more productive regardless of the type of industry they operate in.¹⁹

While there is likely some truth to the former view, there is strong evidence that the adoption of multiple measurable techniques leads to higher output and that within-industry productivity differences are partially explained by within-industry differences in management ability. Any attempt to measure management ability will be limited. The ability of managers to analyse market conditions and make major strategic decisions will inevitably be hard to measure through multiple-choice questionnaires.

For example, Kevin Systrom and Mike Krieger founded a multi-featured check-in app called Burbn that competed with FourSquare. Eventually Systrom and Krieger realised the app was overly complicated and that users were mainly using the app for its photosharing features. They decided to pivot to photosharing and relaunched the app as Instagram, which they eventually sold for \$1bn. It doesn't seem possible to capture and systematically measure this kind of

entrepreneurial *savoir-faire* in any survey response. Yet it appears to be the case that managers who perform well on the measurable aspect of management also perform well on the harder to measure aspects of management.

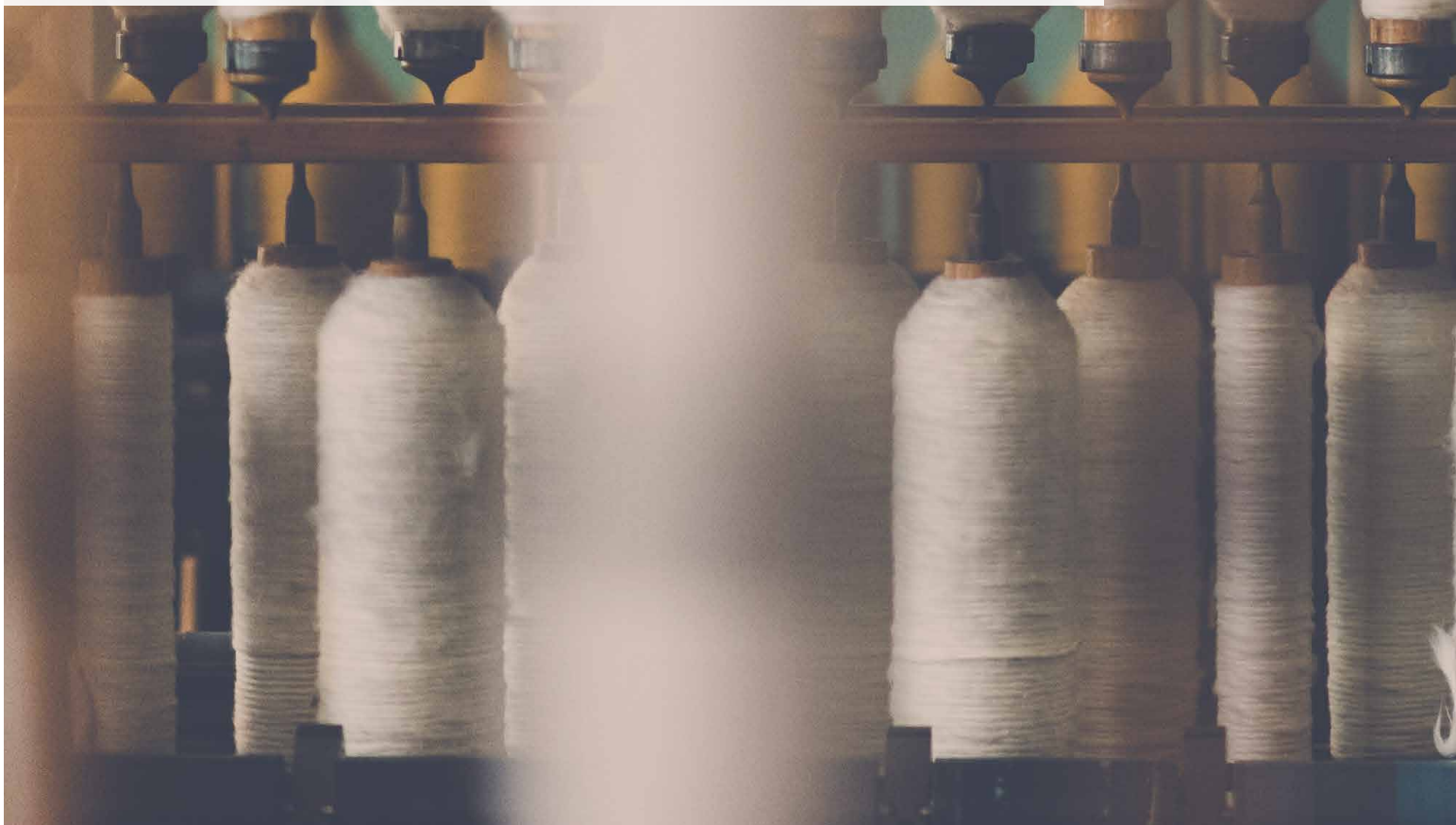
“An alternative view sees management as a form of technology. As managers adopt better techniques they become more productive regardless of the type of industry they operate in.”

The World Management Survey (WMS) interviews plant managers, retail store managers, headteachers, clinical service leads and other middle managers. They're asked open-ended questions such as “Could you please tell me about how you monitor your production process?” and scored out of 5 on 18 different key management practices. The survey focuses on three key areas: monitoring, targets, and incentives/people management. John Van Reenen, one of the economists leading the project states, “a high scoring organization frequently monitors and tries to improve its processes, sets comprehensive and stretching targets, promotes high-performing employees and fixes (by re-training/rotating and, if unsuccessful, exit) underperforming employees.”

CASE STUDY

Improving Management Capability in India

While you don't have to look far for examples of bad managers on TV such as David Brent, Basil Fawlty, and Jack Donaghy, they're typically bad in hard-to-measure ways (for good reason, easily measurable badness doesn't make for entertaining TV). A better way of understanding the idea that management is a form of technology on par with IT systems or mechanised looms is by looking at firms that lack the structured management practices we take for granted.



One illustrative study looked at a management intervention targeted at Indian textile firms.²⁰ The firms in question are strikingly inefficiently managed. The plant floors were disorganised, with chairs blocking access to poorly-maintained machinery and tools left lying on the ground. Inventory rooms had months' worth of excess yarn and lacked any formal labelling system with different types and colours of yarn mixed up. It is easy to see how adopting modern formalised inventory systems could create significant improvements in productivity for each factory.

The textile plants were divided into three groups. Two of the groups received a month long management diagnosis report from Accenture, while the remaining plants did not. Of the two 'treatment' groups, one received no more support after the initial diagnosis, while the other received four months of implementation support.

“It is easy to see how adopting modern formalised inventory systems could create significant improvements in productivity for each factory.”

The results were impressive. They cut quality defects by 50%, inventories by 40% and raised overall productivity by 10%. When they followed the study up 10 years later, the researchers found that firms dropped about 40% of the adopted management practices, but there remained a 19.7 percentage point gap in management practices between the treatment and control plants. The researchers were also able to impute a long-run 19% increase in labour productivity since 2011.²¹

20 Bloom, N, et al. (2013) “Does management matter? Evidence from India.” *The Quarterly Journal of Economics* 128.1 : 1-51.

21 Bloom, N, Mahajan A., McKenzie D., and Roberts. J. (2018) “Do Management Interventions Last? Evidence from India”, NBER Working Paper no. 24249.

Management really matters

High scores on the World Management Survey are linked to stronger productivity, faster revenue and employment growth, and a higher chance of firm survival. Bloom et al surveyed managers at 32,000 US manufacturing plants, finding that management practices vary significantly between plants (40% of this variation is between plants in the same company).²² The study found that performance on the World Management Survey explains 20% of productivity differences between firms. To put that in context, management is as important as R&D and twice as important as IT for productivity.

A further study by Bender et al looked at medium-sized German manufacturers.²³ They found that management scores were strongly correlated with firm-level productivity. Even after controlling for the fact that better managed firms will tend to pay more to hire high-ability workers, the relationship between management and productivity remained strong. Another study by Bloom, Van Reenen and Sadun surveyed 11,000 firms across 34 countries.²⁴ The US had the highest size-weighted management score and multinational firms had higher management scores than domestic firms in each country surveyed. They found that differences in management accounted for half the productivity gap between the US and the UK. Furthermore, they found that a 1 standard deviation increase in management score was associated with a 15% increase in total factor productivity.

Focusing solely on SMEs, a recent study from the National Institute of Economic and Social Research found that SMEs were less likely to use formal management practices than larger firms, but the SMEs that did adopt formal management practices were more productive and grew faster.²⁵ Furthermore, they found that returns were highest for firms investing in human resource management practices, such as training and performance-related pay.

As part of the Business Stay-Up campaign, Gabriel Heller Sahlgren analysed over 10,500 business owners in 21 countries using data from the OECD's Programme for the International Assessment of Adult Competencies (PIAAC)

to study the impact of higher education on entrepreneurial success.²⁶ After controlling for a range of factors including age, gender, first/second generation immigrant status, country-specific factors and numeracy/literacy scores, Heller Sahlgren found that studying business, social science and law predicted firm success. Business owners with a background in social science, business or law are 5% more likely to employ 10 or more people compared with business owners with backgrounds in general programmes.

“High scores on the World Management Survey are linked to stronger productivity, faster revenue and employment growth, and a higher chance of firm survival.”

Why don't good practices spread?

If formal management practices are so strongly linked to productivity growth then it raises the question, why don't more firms adopt them? A recent Institute of Directors (IoD) study found that larger firms were more likely to have adopted targeting, monitoring, and incentive strategies. In particular, only 56% of small firms invested in management/leadership training, while over 80% of large firms had.²⁷

Henderson and Gibbons identify four key reasons why SMEs fail to adopt management best practices: perception, inspiration, motivation, and implementation.²⁸ First, managers may fail to spot that they're behind if they're failing to actively monitor worker productivity, as 60% of SME IoD members say they are. An evaluation of the Swedish Business Development Program found that firms applying for business support benefited more from setting aside time to assess business problems in order to fill out an application for support than the support itself.²⁹

22 Bloom, N., Brynjolfsson, E., Foster, L., Jarmin, R. S., Patnaik, M., Saporta-Eksten, I., & Van Reenen, J. (2017). "What drives differences in management?" (No. w23300). *National Bureau of Economic Research*.

23 Bender, S., Bloom, N., Card, D., Van Reenen, J., & Wolter, S. (2018). Management practices, workforce selection, and productivity. *Journal of Labor Economics*, 36(S1), S371-S409.

24 Bloom, N., Sadun, R., & Van Reenen, J. (2016). "Management as a technology?" Working Paper 16-133, *Harvard Business School*

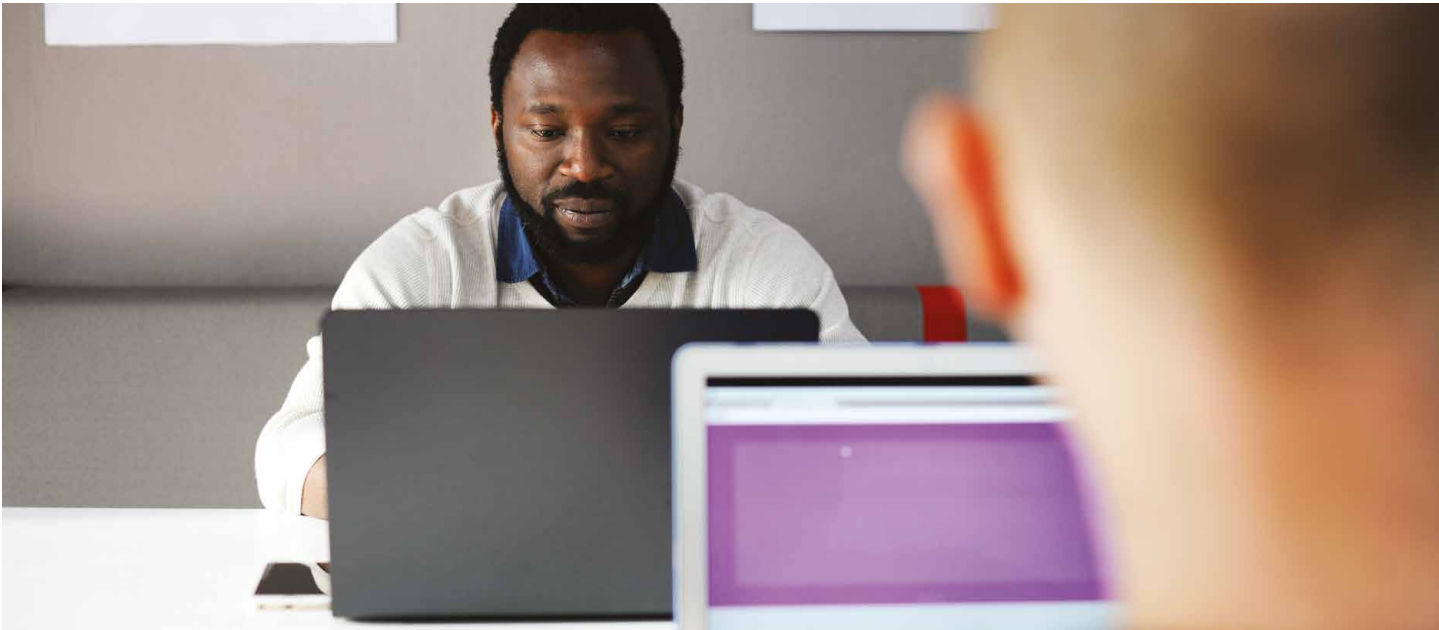
25 Forth, J. and Alex B. (2018) "The impact of management practices on SME performance." Discussion Paper No. 48, *NIESR*

26 Heller Sahlgren, G. (2018) *Human Capital and Business Stay-up*, Centre for Education Economics

27 Parikh, T. (2018) *Lifting the long tail: the productivity challenge through the eyes of small business lenders*. Institute of Directors

28 Henderson, R. and Gibbons, R. (2013) "What do managers do? Exploring Persistent Performance Differences among Seemingly Similar Enterprises" in *The Handbook of Organizational Economics*, Princeton University Press, Princeton and Oxford

29 Parikh, T. (2018) *Lifting the long tail: the productivity challenge through the eyes of small business lenders*. Institute of Directors



Second, even when businesses know they're falling behind they might not know what to do about it. SMEs may find choosing between a course on Agile, Scrum or PRINCE2 puzzling. Without trusted advice on which techniques will best meet their business' needs they simply won't risk investing in new training programmes that might not pay off.

Third, managers may lack motivation. Even when they've diagnosed the problem and identified a solution, managers may still lack an incentive to take the next step. The cost of training may act as a barrier, as may the risk of disruption as working practices change.

Finally, even when managers identify the right practices and commit to investing in adopting them, they may still struggle to implement them. Their workforce may be averse to change and without changes to the company's culture attempts to implement better practices may fail.

Why are firms better managed in some countries?

Bloom and Van Reenen analysed survey data from 732 medium-sized manufacturing firms across the UK, US, Germany, and France.³⁰ They found that US firms were on average better managed than European firms and that management scores were lowest in the UK. The UK (and to a lesser extent France) have low average management scores in large part due to a long tail of badly managed firms. Bloom and Van Reenen identify two causes of the UK's underperformance relative to the US. First, they identify that UK and French firms have a higher proportion of family-firms that pass management control through primogeniture (first born son) rather than hiring outside managers. They cite evidence showing that while family ownership has a mixed effect on profitability, family management has a significantly negative effect on profitability. Second, Bloom and Van Reenen find that poor management practices are more prevalent when product market competition is weak. Together these two factors explain about

half of the long tail of poorly managed firms and two-thirds of the American advantage over European firms.

In another paper Bloom et al identify three other factors: business environment, learning spillovers, and human capital.³¹ Comparing US states with "Right to Work" laws which weaken union power and are a proxy for other "pro-business" policies to "Non-Right to Work" states, Bloom et al found that states with a low-regulation business environment were more likely to use structured management practices around hiring, firing, and promotion, but were no more likely to use other structured management practices. They also found that when a multinational opened a large manufacturing plant within a county, other firms in the county adopted better management practices. Highlighting the importance of human capital, they also noted that plants located close to universities and thus able to attract more skilled labour were better managed. The three factors combined plus competition are able to explain one third of the 90:10 productivity gap in the US.

30 Bloom, N., & Van Reenen, J. (2007). "Measuring and explaining management practices across firms and countries." *The Quarterly Journal of Economics*, 122(4), 1351-1408.

31 Bloom, N., Brynjolfsson, E., Foster, L., Jarmin, R. S., Patnaik, M., Saporta-Eksten, I., & Van Reenen, J. (2017). "What drives differences in management?" (No. w23300). *National Bureau of Economic Research*.

“International evidence found that offering firms free advice on management practices raised productivity by 11% on average.”

Access to advice

Alongside higher education, management skills can be developed both on-the-job and through external training courses. International evidence found that offering firms free advice on management practices raised productivity by 11% on average.³² Likewise, programs in the UK such as Goldman Sachs’ 10,000 Small Businesses Project (see Case Study for further information) have delivered impressive outcomes. But despite the large potential benefits of investing in management training, UK firms underspend on training relative to their international counterparts. The graph adjacent shows that the UK firms spend less on job-related adult education than many other OECD nations including Germany, the United States, Canada and New Zealand.

Survey data from the Institute of Directors shows that small businesses are less likely to invest in employee or management/leadership training than medium or large businesses. More than four-fifths of large businesses fund management/leadership training, while only 55% of small businesses and 70% of medium-sized businesses did the same. To an extent we shouldn’t be surprised. Larger firms typically employ more people and manage more complex production processes, as a result management training will be particularly useful for them. However, the IoD’s survey data may underplay the gap. The Small Business Survey (collected by BEIS) interviewed 6,619 SME owners/managers and reports that only 32% of SME employers provided training for managers. Of the 32%, over a third provided training for management or leadership skills. Though among medium-sized firms this number increases to 73%.

There is evidence that quality of advice acts as a key barrier to the take-up of new management practices. In the same IoD survey, less than 20% (on net) of small firms viewed the quality of available business advice on management practices positively, compared with 33% (on net) of large firms. Of the firms surveyed many listed “insufficient time to test/research solutions” and “difficulty measuring the potential benefits” as major challenges to developing management practices.

CHART 3: THE SHARE OF BUSINESS OWNERS ENGAGING IN JOB-RELATED ADULT EDUCATION AND TRAINING



OECD/Source: Business Stay-Up and Human Capital

32 Bloom, N, et al. (2013) “Does management matter? Evidence from India.” *The Quarterly Journal of Economics* 128.1 : 1-51.

CHART 4: IOD SMALL, MEDIUM AND LARGE TAKE-UP OF MANAGEMENT/LEADERSHIP TRAINING



Source: IoD Policy Voice Survey, June 2018, 720 respondents.



CASE STUDY

10,000 Small Businesses

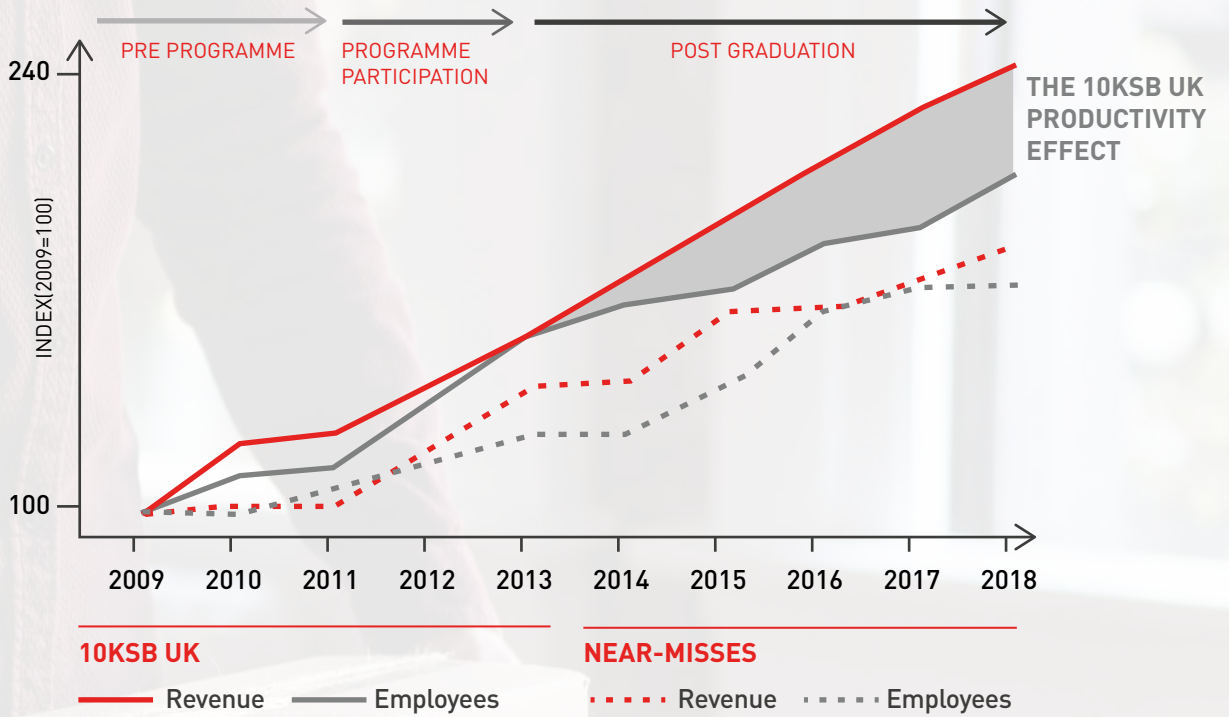
The Goldman Sachs 10,000 Small Businesses programme is designed to provide high-quality business support and leadership for scalable, small businesses. Participants receive 100 hours of expert tuition through a mix of online and residential learning. The programme is run in partnership with Said Business School at Oxford University, the Aston Centre for Growth at Aston University, Leeds University Business School at the University of Leeds, and the Manchester Metropolitan University Business School at Manchester Metropolitan University. The course covers themes key to business productivity such as: technology, internationalisation, innovation, branding and resilience.

To qualify for the programme businesses need to have been operating for at least three years, have between 5 and 50 employees and have a turnover of at least £250,000 in the previous financial year. The applicant must be the primary owner or main decision maker of the business and should not have extensive or recent management education.

Of the programme's participants, 30% are women (compared to 21% of business owners for the UK). More than two-thirds are between 30 and 50 years old and there are more 50 plus participants than under 30s. Of the cohort, over a third of participants do not have a university-level degree and the businesses that go through the programme are on average 18 years old.

Goldman Sachs quantify impact by comparing 10,000 Small Businesses participants with 'near-misses' (firms that applied and are similar on paper but failed to get through the final stage). Participants created 23% more jobs than 'near-misses' and generate 25% higher revenues than similar high-growth small businesses. 74% of programme graduates increase the training opportunities they provide to their staff after graduating and 71% of graduates take on external financing, twice the national average for similar firms. Goldman Sachs estimate (after controlling for their already high growth trajectory) that 10,000 Small Businesses alumni have created 5,840 jobs and £307m of gross value added to the UK economy.

CHART 5: FROM 2018 GS 10KSB IMPACT REPORT



Business Angels and non-executive directors (NEDs) can play an important role in overcoming the informational barriers that prevent SMEs from adopting better management practices. Andy Haldane highlights Bank of England research on boardroom connectivity. The research revealed that there are a small set of companies with hyper-connected NEDs and a long tail of firms with loosely or unconnected NEDs. The distribution mirrors the ‘long tail’ distribution of productivity performance and management skills. As a thought experiment, Haldane imagines a comparison between two otherwise identical companies who differ only in boardroom connectivity with one in the top 10% and the other in the bottom 10% for connectivity. Haldane’s analysis finds that “average annual productivity growth for the in-crowd company is around 1 percentage point higher than for the out-crowd company.” A possible explanation for this large impact on productivity growth is that connected firms are able to move past information barriers that prevent the adoption of better managerial practices.

This line of research may have implications for regional inequality. While business angels are no longer solely investing in their home region (as previous research suggested), it is still the case that business angels are more likely to invest closer to home. Likewise, intuitively NEDs will be less likely to join a board if they have to travel far to attend board meetings. Allowing high-productivity cities such as London, Oxford and Cambridge to expand, for instance by relaxing Green Belt restrictions and improving transport links with nearby towns, may be key to increasing boardroom connectivity.

The policy landscape

In the Government’s *Industrial Strategy: Building a Britain fit for the Future* White Paper, they highlight the importance of spreading managerial best practices as part of their ambition for Britain to be the best place to start and grow a business. To support this agenda, BEIS commissioned a Business Productivity Review (awaiting publication). In the call for evidence, they summarised the research around management and productivity, and asked for submissions on “the main reasons for businesses adopting or not adopting management best practice?” and “which actions by the public or private sector would be most effective to facilitate effective adoption and embedding of management practice?”.

BEIS also launched an £8m Business Basics fund to boost the productivity and performance of small businesses in England. The fund will support projects that help small companies adopt tried and tested technologies and management techniques. The department will work with expert groups to evaluate each project to inform future policy.

“Allowing high-productivity cities such as London, Oxford and Cambridge to expand, for instance by relaxing Green Belt restrictions and improving transport links with nearby towns, may be key to increasing boardroom connectivity.”

The Government is also backing Be The Business, an industry-led initiative created by the Productivity Leadership Group (PLG). The initiative allows businesses to benchmark themselves against best practice on areas such as leadership, employee engagement, future planning, and digitisation. Their Mentoring for Growth programme uses local Growth Hubs to match SME leaders to mentors from leading businesses such as GSK, Amazon, and John Lewis. After a successful six-month pilot programme which created 41 mentoring relationships, the scheme will be rolled out nationwide.

In the most recent budget, the Chancellor announced additional funding to support management capabilities. This included a Small Business Leadership Programme delivered in partnership with business schools and leading firms. The Government has set an ambition for 10,000 people to have been trained through the programme by 2025. They also committed £20m in investment to support local peer-to-peer networks focused on business improvement and up to £25m to place over 200 additional graduates and academics into firms to help businesses grow.

It is important that the Government learns from past initiatives to support business growth such as Growth Vouchers and Growth Accelerator, which provided coaching for SMEs and fast-tracked clients to trusted providers of business advice.

“The threat of more intense competition will force incumbent businesses to become more efficient, reduce prices and invest in developing better products.”

THE STAY-UP AGENDA

We need a Stay-up Agenda. Equipping fledgling business owners with the tools to help their businesses survive and, eventually, thrive isn't just good for the business owners themselves. Workers benefit too, and not just by avoiding temporary bouts of unemployment. There is a strong link between productivity growth and wage growth.³³ A recent report by the Resolution Foundation found that productivity is the biggest factor holding back pay growth in the UK. As previously stated, closing the productivity gap between the top and bottom three quartiles would boost UK productivity by 13%. This would raise GDP by £270bn or £8,330 per worker.³⁴ Better managed workers aren't just more productive and better paid either, they're happier too. Research from Bryson, Forth, and Stokes found “a clear, positive, and statistically significant relationship between employees' subjective well-being and workplace performance in Britain”.³⁵

Equipping marginal businesses with the management skills to stay-up will also increase competitive pressures. This will expand consumer choice, and raise productivity even further as new, more efficient stay-ups are able to take market

share from established firms. The threat of more intense competition will force incumbent businesses to become more efficient, reduce prices and invest in developing better products.

33 Clarke, S. and Gregg, P (2018) *Count the pennies: Explaining a decade of lost pay growth*. The Resolution Foundation.

34 Haldane, A. (2018) *The UK's Productivity Problem: Hub No Spokes*. Academy of Social Sciences Annual Lecture.

35 Bryson, A., Forth, J., & Stokes, L. (2017). “Does employees' subjective well-being affect workplace performance?” *Human Relations*, 70(8), 1017-1037.

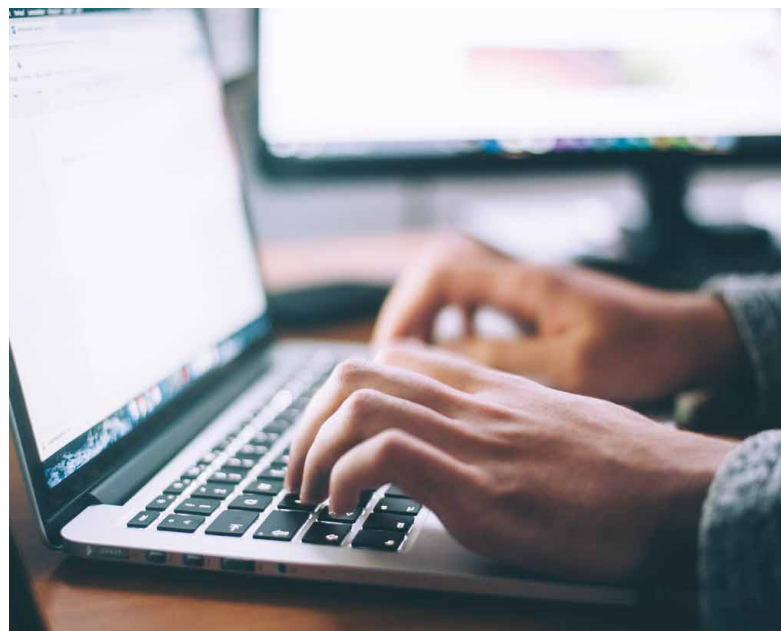


RECOMMENDATION 1: IDENTIFY WHAT WORKS BY SPONSORING RANDOMISED TRIALS OF PROMISING TRAINING INTERVENTIONS

But before we intervene, we need to know what works. The recently announced £8m Business Basics fund is taking the right approach by partnering with expert groups to evaluate each programme. While there is strong evidence that better management leads to higher wages, higher employment and higher revenue growth, the evidence on specific programmes is patchier. Partly due to cost, most research into specific interventions is international and focused on less economically developed countries. As a result, it's hard to generalise to the UK economy.

The Government's evaluation of the (now discontinued) Growth Vouchers programme is a good example of evidence-based policymaking. The Department for Business, Innovation and Skills randomly assigned 28,000 businesses who applied to receive a £2,000 voucher to access business advice to treatment and control groups. Three-quarters of businesses received the voucher while a quarter didn't. The evaluation compared the performances of each group and found a positive impact on business-planning and turnover growth for the group receiving the vouchers. The Government ought to replicate this 'Gold Standard' randomised control trial (RCT) approach and apply it more broadly to the issue of business support and training interventions.

In *Human Capital and Business Stay-Up*, Heller Sahlgren recommends adopting a similar approach to the Education Endowment Foundation, which was set up to run trials into what works for improving pupil performance. The Education Endowment Foundation is an independent charity and was set up with a £125m founding grant from the Department for Education. It develops tools and funds evaluations of promising approaches to improve pupil attainment and is a part of the Government's What Works network. The government should consider funding a similar What Works Centre for management capability. It could be funded in part from money currently earmarked for existing business support such as Local Enterprise Partnership (LEPs) or management capability initiatives.



RECOMMENDATION 2: ALLOW EMPLOYEES AND THE SELF-EMPLOYED TO BENEFIT FROM TAX BREAKS WHEN THEY FUND THEIR OWN TRAINING.

Alongside improving the knowledge base for policy makers, the government should also look to strengthen incentives for workers to fund their own training. Under the status quo, employers who fund work-related training for their employees receive tax relief but employees who fund their own training receive no tax benefit. The situation is more complex for the self-employed, who can receive a deduction against income for the costs of training where the training maintains or updates existing skills but cannot receive a deduction against income if the training introduces new skills. For instance, a graphic designer undertaking a marketing course to improve their prospects at attracting new clients wouldn't be eligible for a tax relief.³⁶

The situation is far from ideal. A significant number of employers fail to offer and fund adequate training options. Instead, employees are forced to fund their own training at a tax disadvantage. The UK is a relative outlier on this front. A recent OECD study found that 21 out of 30 countries studied provided a deduction for work-related training incurred costs from taxable income.

At the recent Budget, the Government responded to a consultation on self-funded work-related training and rejected extending tax relief to self-funded work-related training over concerns that direct spending would be more cost-effective at incentivising those on low incomes to self-fund training.

One option, highlighted in the Chartered Institute of Taxation's submission to the consultation, would be to provide an upfront tax credit equivalent to the basic rate of income tax. This would have two key advantages over a straightforward deduction.³⁷ First, it would address the Government's concern that deductions don't incentivise the low-paid, such as those earning below the tax free allowance. Second, by providing an upfront credit, it would ease cashflow issues which would be a particular concern for low-paid workers who may struggle to get credit.

There would be a need to restrict expenditures so that only approved work-related training is used. In the 1990s, the now-defunct vocational training tax relief was criticised in the past for bankrolling hobbyists. At the same time, there needs to be a recognition that the existing rules are too restrictive. The aforementioned graphic designer should be able to receive a tax benefit for a digital marketing course.

³⁶ HM Treasury (2018) Taxation of self-funded work related training: summary of responses.

³⁷ Chartered Institute of Taxation (2018) Taxation of self-funded work-related training: Consultation on the extension of tax relief for training by employees and the self-employed

RECOMMENDATION 3: REFORM THE APPRENTICESHIP LEVY TO ALLOW FIRMS TO INVEST IN IMPROVING THE MANAGEMENT CAPABILITY OF FIRMS IN THEIR SUPPLY CHAINS.

The government's flagship Apprenticeship Levy, which requires employers with a payroll of over £3m to pay 0.5% of their wage bill to fund apprenticeships, has come under significant criticism from businesses who charge that it is too complex and too inflexible. An IoD survey found that just 14% of employers believe the levy is fit for purpose and instead perceive the levy as just another tax.³⁸ Many employers have stated they either won't fully spend their levy contribution on creating new apprenticeships or will reallocate existing training budgets towards apprenticeships. Just 19% of employers said they will take on more apprentices than otherwise.

In the most recent budget, the Chancellor responded by confirming additional flexibility for firms paying the Apprenticeship Levy. Levy-paying employers will now be able to transfer 25% of their levy payments to employers in their supply chain. However, there is still a strong case for further reform. 40% of Levy-paying employers believe "I cannot find relevant Government Apprenticeships standards (courses) for my firm's training needs", while 60% say "My firm would benefit more if allowed to use our Levy funds for other forms of training (e.g. short courses, traineeships, MOOCs etc.)"³⁹

There are also concerns that Apprenticeship Levy funds are being used for unintended purposes. Rather than providing an alternative vocational route for under 21s, Levy contributions are being used to fund older workers taking MBAs at business schools. Paul Baines, MBA course director at Cranfield University's School of Management, told the Financial Times that he expected to have 150 students in 2018 on the Apprenticeship Levy version of their executive MBA course. While clearly not the Government's intention, criticism of "incorrectly labelled" MBA apprenticeships may be misplaced. As previously stated, improving the quality of British management is key to solving our productivity crisis.

The real issue may instead be that the levy is shifting employers towards funding time-intensive and less cost-effective management training programmes when they would be better off sending managers on shorter, cheaper training courses. As a result, we echo the recommendations of the Institute of Directors⁴⁰ and OECD⁴¹ that the Apprenticeship Levy be rebranded as a more flexible general training levy. Under this more flexible system, levy funds could still be

restricted to ensure they're only spent on developing in-demand skills as the OECD suggests. At the very least, there should be recognition from government that the existing array of high-quality (but time-intensive and costly) management courses on offer through the Apprenticeship Levy, such as MBAs as well as the Senior Leaders and Chartered Management apprenticeship degrees, are not the best option for every firm.

While in the short-term improving the provision of management training within large employers may not help the current crop of marginal businesses stay-up, in the long-term it will lead to the next generation of business owners being better equipped. Contrary to the stereotype of the twenty-something start-up founder, the average entrepreneur is 40 years old when she founds her first business.

“While in the short-term improving the provision of management training within large employers may not help the current crop of marginal businesses stay-up, in the long-term it will lead to the next generation of business owners being better equipped.”

But reform should also support existing SME owners too. The recent reform to allow Levy payers to transfer up to 25% of their Levy payments to fund apprenticeships for firms within their supply chain is welcome, but should go further and allow an additional 25% to be transferred to firms in their supply chain as the CBI has recommended. To ensure that these funds support the long tail, the Government could place a condition that this additional 25% be targeted at SMEs rather than large suppliers as the FSB have requested.

38 Institute of Directors (2018) "New business survey shows need for Apprenticeship Levy reform"

39 Institute of Directors (2018) "Business leaders finally getting to grips with apprenticeship levy"

40 Parikh, T. (2018) Lifting the long tail: the productivity challenge through the eyes of small business lenders. Institute of Directors

41 OECD (2017) Getting Skills Right: United Kingdom.



RECOMMENDATION 4: THE GOVERNMENT SHOULD BACK THE CREATION OF PEER-TO-PEER NETWORKS FOR SMES TO SHARE MANAGERIAL BEST PRACTICES.

The Government will inevitably face limits when trying to improve the productivity of marginal businesses. They cannot feasibly require that business owners adopt structured management practices. Changing incentives through tax breaks and subsidies can change behaviour at the margin, but it won't resolve underlying issues if there are informational barriers to adopting new management practices. Government has a role to play as a convenor rather than as a direct supplier of information. SME owners are unlikely to welcome advice from civil servants on how to run their own businesses. On top of this, constant government reorganisation may leave business owners unsure of where to seek advice.

“A large study in China found that when firms were randomly assigned to groups that met once a month for a year, firm revenue increased by 8.1% alongside profitability and management score.”

For instance, IoD polling found just 6% of small businesses saw Local Enterprise Partnerships or Growth Hubs as among

the top 3 sources of support to improve their organisation's productivity. Initiatives to increase the uptake of managerial best practice should be business, not government, led. Government's role instead should be to direct SMEs to what works and to champion it in the media.

A large study in China found that when firms were randomly assigned to groups that met once a month for a year, firm revenue increased by 8.1% alongside profitability and management score.⁴² Furthermore, firms that were assigned to groups with better-performing peers experienced higher growth.

Strengthening existing peer-to-peer networks and providing funding support to get new ones off the ground in underserved regions will help SMEs overcome the informational barriers to seeking out management training and adopting best practices.

42 Cai, J., & Szeidl, A. (2017). "Interfirm relationships and business performance." *The Quarterly Journal of Economics*, 133(3), 1229-1282.

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ABOUT THE BUSINESS STAY UP CAMPAIGN

Business stay-up is a research-led campaign to raise awareness of the pressures and challenges business owners face as they seek to survive and scale, and understand what can be done to increase the probability of success.

Business failure and resulting creative destruction drives forward a market economy. However, not all business failure is necessary and unavoidable. For example, a lack of management or employee skills, poor financial management and operational mismanagement can destroy what would be an otherwise successful business. More can and should be done to raise the probability of firm survival – or Business Stay-up. Future entrepreneurship policy must identify and stimulate factors that help firms survive and thrive.



ABOUT THE ENTREPRENEURS NETWORK @TENTHINKTANK

The Entrepreneurs Network is independent, non-profit and non-partisan. We support entrepreneurs by:

- Producing cutting-edge research outlining the benefits of easing unnecessary burdens upon enterprise;
- Hosting regular events to bridge the gap between the aspirations of the entrepreneurial community and policy makers;
- Building a network of entrepreneurs who are keen to improve the public policy debate;
- Championing entrepreneurship and making the case for a more entrepreneurial society.

We are also the Secretariat of the APPG for Entrepreneurship. The APPG for Entrepreneurship was set up to encourage, support and promote entrepreneurship and to engage with entrepreneurs; and to ensure that Parliament is kept up to date on what is needed to create and sustain the most favourable conditions for entrepreneurship.



appg entrepreneurship



ABOUT THE ASSOCIATION OF BUSINESS EXECUTIVES @ABETALK

As the pioneer in global business education, the Association of Business Executives (ABE) was founded more than 40 years ago with a clear social purpose to improve business education for aspiring entrepreneurs in developing countries, many of which are now high-growth economies. That pioneering spirit remains as we seize new challenges to engage millennials with flexible and relevant learning content and credentials.

Today, ABE works all over the world and 1.5 million people have mastered essential modern business concepts and gained the skills and confidence to apply them through ABE's active-learning courses. ABE continues to play a vital role in helping to diversify and grow economies, reducing inequality within and among countries, and is at the forefront of the entrepreneurial skills agenda.



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