



Centre for Enterprise, Innovation and Growth,  
Birmingham City Business School  
March 2021

# THE SME 'DRAG EFFECT' ON THE WEST MIDLANDS ECONOMY

**Deniz E. Yoruk and Mark Gilman**



# CONTENTS

<b>1.</b>	<b>INTRODUCTION</b>	<b>4</b>
<b>2.</b>	<b>THE WEST MIDLANDS ECONOMY IN THE LAST TWENTY YEARS</b>	
2.1.	ECONOMIC INDICATORS	5
2.1.1	The West Midlands in the UK economy	5
2.1.2	Greater Birmingham and Solihull Local Enterprise Partnership (GBSLEP) and Black Country Local Enterprise Partnership (BCLEP) in the UK economy	8
2.2.	CHANGING INDUSTRY STRUCTURE	10
2.2.1	The Industrial Structure of the West Midlands	10
2.2.2	The Industrial Structure of GBSLEP and BCLEP	12
2.2.3	West Midlands' SMEs by industry	14
<b>3.</b>	<b>THE SME SECTOR IN THE WEST MIDLANDS</b>	
3.1.	GENERAL STATISTICS	16
3.2.	SME GROWTH IN WEST MIDLANDS	22
3.2.1.	Turnover Growth of SMEs	22
3.2.2	High-growth instances	22
3.2.3	High-growth firms	24
<b>4.</b>	<b>IDENTIFYING THE 'DRAG EFFECT' OF SMEs on WEST MIDLANDS' ECONOMY</b>	<b>27</b>
<b>5.</b>	<b>CONCLUSION</b>	<b>33</b>
	REFERENCES	33
	APPENDIX	35

# KEY POINTS

Our main objective is to highlight that deeper and targeted investigation of the development and growth of SMEs in particular regions might facilitate policy development that drives SME growth. With this in mind, we have produced three reports, of which this is the first.

This report focuses on the key economic data on the West Midlands in the last twenty years with the main objective of providing an analysis of the SME economy in the West Midlands with a particular focus on the Greater Birmingham and Solihull Local Enterprise Partnership (GBSLEP) and Black Country Local Enterprise Partnership (BCLEP).

Our findings show that in the last five years whilst the West Midlands' was experiencing prospering economic growth prospects the SME part of the economy was experiencing a 'drag effect'.

Our analysis highlights a flourishing West Midlands economy since the 2008 Global Financial Crisis (GFC). However, a detailed look at the SME data displays an intensifying low set of productivity levels in the region's SME economy indicating that the West Midlands economy does not necessarily operate at its full potential.

Despite the improving productivity levels in the West Midlands since 2012, the productivity levels of GBSLEP lagged significantly behind the West Midlands productivity levels until 2016. Oscillations in the productivity levels of BCLEP has been commonplace since 2008 GFC.

We postulate the differences in the productivity patterns of GBSLEP and BCLEP might be due to the changes in their industrial structure, in the characteristics of SMEs and in the targeted SME policies:

- A regional productivity analysis by ONS (2018a) substantiates the West Midlands being the only region with an SME drag effect due to a contrasting relationship between industry structure and firm productivity. The changes to the industry structure positively affect the region's productivity levels, yet it is not large enough to compensate for the effect of the low average firm productivity levels.
- We observe a deepening productivity problem in micro and small enterprises in the West Midlands more than any other firm category.
- The West Midlands' share of HGFs is below the UK average and fluctuating from year to year without ensuring a steady impact on productivity. The share of HGFs in GBSLEP and BCLEP continues to fall as opposed to a recovery, as would be expected from the targeted policies these firms received.

We recommend that reducing the SME drag effect on the West Midlands economy can be achieved by shifting attention to SMEs that grow 5-20% annually and/or over the three years.





# 1. INTRODUCTION

In line with recent government policies and the growth of the Local Economic Partnerships, a deeper and targeted investigation of the development and growth of SMEs in particular regions might facilitate further policy development on what drives SME growth. With this in mind, we have produced three interlinked reports, of which this is the first. This report analyses the key economic data on the West Midlands, mostly from the Office for National Statistics (ONS). We examine the evolution of the West Midlands economy in the last twenty years, followed with an analysis of the SME segment of the economy, particularly in the Greater Birmingham and Solihull Local Enterprise Partnership (GBSLEP) and Black Country Local Enterprise Partnership (BCLEP) areas.

Our findings highlight a contrasting phenomenon happening between the overall West Midlands economy and the SME economy, where the latter is slowing the potential growth of the former. We call this phenomenon a SME 'drag effect' on the buoyant economy experienced by the West Midlands. Our secondary data analysis, on the one hand, highlights the flourishing overall West Midlands economy since the 2008 Global Financial Crisis (GFC) up until the Coronavirus Pandemic hit in March 2020. A detailed look at the SME data, on the other hand, displays relatively low turnover and intensifying low productivity levels in the region's SME economy, which indicates that the West Midlands economy did not necessarily operate at its full potential.

The SME sector accounts for 99.9% of the total enterprises, 58% of the total employment and 44% of total turnover in the West Midlands' economy in 2019 (and similar figures in the previous years). Therefore, the need to understand this phenomenon, and better still address it, is essential for continued growth post Covid.

The first section of the report examines the characteristics of the West Midlands economy in the last twenty years, compared with the rest of the UK, including the changing industrial structure and its impact on the contribution of the SMEs. The second section examines the SME sector with particular interest on their levels of growth. The third section discusses the drag effect of SMEs in the light of discussion on UK productivity problem.



## 2. THE WEST MIDLANDS ECONOMY IN THE LAST TWENTY YEARS

*The Midlands is 'the heartland of the UK economy' (Midlands Engine Strategy 2017).*

*The West Midlands is 'a global force', 'a fast growing region' and 'a major part of the UK economy' (Local Industrial Strategy for West Midlands, May 2019).*

*Birmingham ranks 23rd among 60 European cities for Start-ups. It is a leading business destination in Europe, with major global manufacturing players, improving financial sector, thriving tech community and developing SME sector (European Digital City Index 2016)<sup>1</sup>.*

In the last five years, many statements produced similar to the above indicate the important and potential contribution the region plays within the overall UK economy. In the next sections, we will examine this contribution of the West Midlands economy, and the Greater Birmingham and Solihull Local Enterprise Partnership (GBSLEP) and Black Country Local Enterprise Partnership (BCLEP) in particular, using key economic indicators, such as GDP, GVA and its ranking in European Regional Competitiveness Index.

### 2.1. ECONOMIC INDICATORS

#### 2.1.1 The West Midlands in the UK economy

Since 2004, the West Midlands<sup>2</sup> has consistently ranked as the seventh largest economy among twelve (NUTS1) regions of the UK by its gross domestic product (GDP). Yet, it was the hardest hit region during the economic turbulent times as in 2000-2001 and the global financial crisis of 2008-2009 (Figure 1). Until 2010, the West Midlands' economy grew annually below the UK average. Between 2013 and 2018, however, the region been growing above the UK average, and greater than all regions except London and the East of England. Since 2014 the GDP growth of these three top performers has been converging due to a fall in GDP growth of the East of England and the West Midlands, and a slight improvement in that of London.

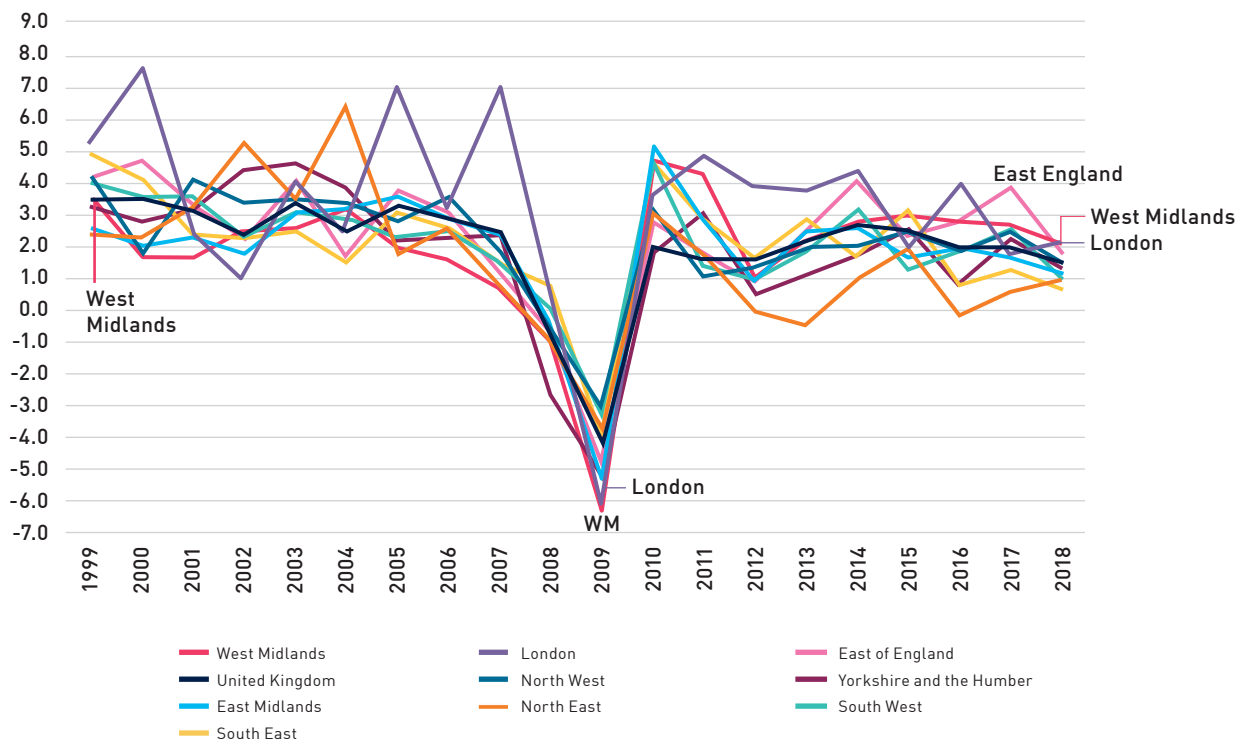
Figure 2 displays the economic recovery in the West Midlands through the comparison of average growth rate of GDP per head between the periods 1998-2008 and 2009-2018. While many of the regions, including London, were experiencing a fall in their GDP per head between these two 10-year periods, the West Midlands has achieved the highest increase from 0.8% during 1998-2008 to 1.8% during 2009-2018 (1 percentage point).

---

<sup>1</sup><https://digitalcityindex.eu/city/37>

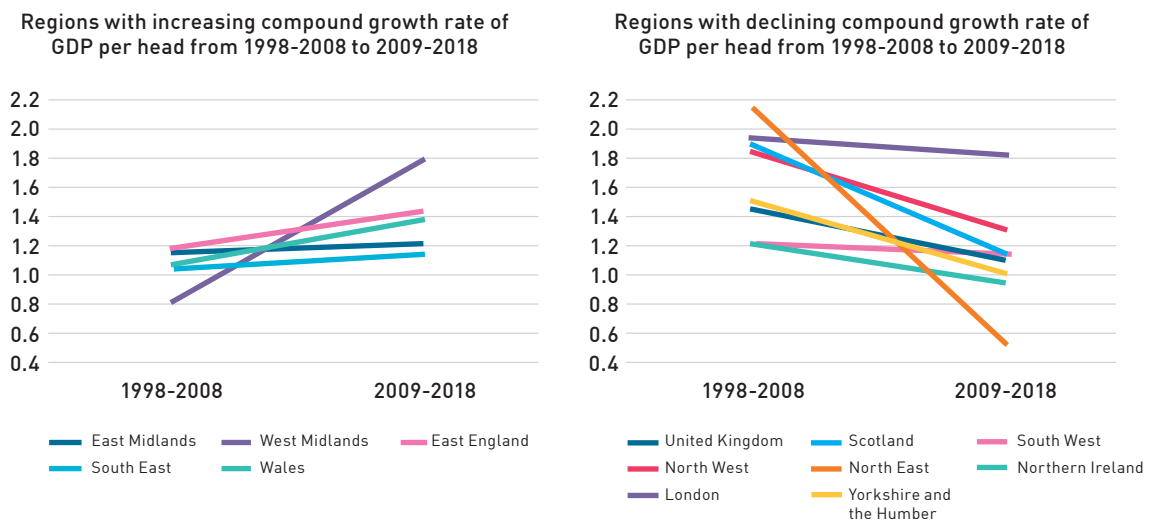
<sup>2</sup>See Appendix for the classifications of West Midlands region used in this report. The West Midlands region, on which data is presented in this section, is composed of three main (NUTS2) sub-category of Herefordshire, Worcestershire and Warwickshire; Shropshire and Staffordshire; and West Midlands (Met County). West Midlands (Met County) includes the councils of Birmingham, Solihull, Coventry, Dudley, Sandwell, Walsall and Wolverhampton.

**Figure 1. Gross Domestic Product, annual growth rates, 1999-2018**



Source: ONS

**Figure 2. Compound growth rates of GDP per head in regions from 1998-2008 to 2009-2018**

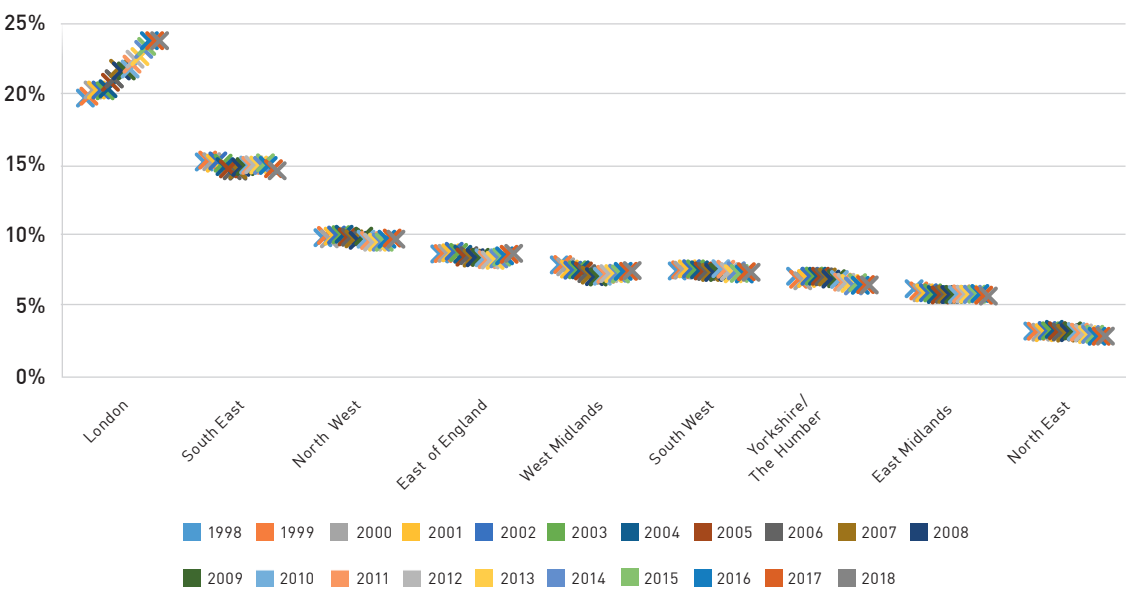


Source: ONS



The Gross Value Added (GVA) of the West Midlands, which is more commonly used to understand a region's economic output<sup>3</sup>, shows similar patterns to GDP as in Figure 1. Over the last 20 years, out of nine regions, the West Midlands is the fifth largest contributor to the UK's GVA, and is on a par with the contribution of the South West (Figure 3). Due to the most severe hit to its economy during the GFC (as observed in Figure 1), the West Midlands' share in the UK's GVA fell from 7.9% in 1998 to 7% in 2009, the highest fall (11%) among all regions. Since GFC, after London, the West Midlands experienced the second fastest recovery (6% change between 2009 and 2018) but still has some catching up to do with its 1998 share in the UK's GVA.

**Figure 3. Trends in the share of each region in the UK's GVA, 1998-2018, %**



Source: ONS

Short-term evidence on the West Midlands' economy doing relatively well against the gloom of the 2008 GFC comes from the European Regional Competitiveness Index (RCI).<sup>4</sup> The index compares West Midlands' sub-regions<sup>5</sup> with alike European and UK regions and hence provides a bigger picture of how the West Midlands actually compares<sup>6</sup>. The West Midlands (Met County) ranked at 81st among 268 regions in 2013 and fell sharply down to 96th position in 2019.

<sup>3</sup>We use Balanced GVA(B) in real terms in chained volume measures (CVM), with the effect of inflation removed.

<sup>4</sup>Because RCI is a composite index of a variety of aspects, it enhances our understanding of the competitiveness of regions and eases comparability. The index does not rely only on macroeconomic measures for economic stability and growth, but also other aspects such as business sophistication, technological readiness, market size, labour market efficiency, the quality of institutions, infrastructure, health, basic and higher education.

<sup>5</sup>See Table A1 in the appendix for description of each sub-region.

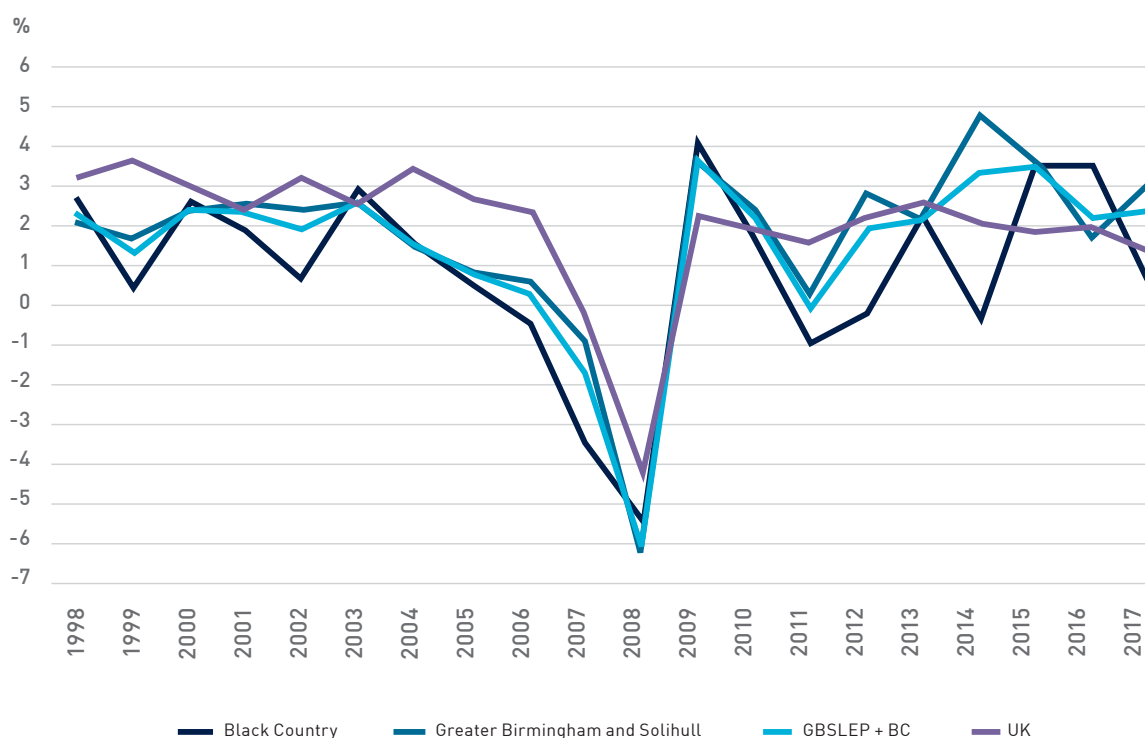
<sup>6</sup>RCI does not include GDP per head directly, for it would not be fair to compare any region with London area for instance. However, when RCI is compared with GDP per head, the authors of the 2019 report (Annoni and Dijkstra, 2019) have found that a slight increase in GDP per head is linked to a clear increase in competitiveness of the region (p. 23). Since West Midlands region as a whole has shown an annual increase of 1.3% in GDP per head from 2017 to 2018, we might deduce that the overall RCI might have improved.

Experiencing a fall in its development stage, the West Midlands (Met County) with Birmingham and Coventry at its core presents similar traits to its peers in the EU28 in terms of institutions, basic education and health, yet it outrivals them in infrastructure. In terms of efficiency, the region is similar to average EU regions in labour market efficiency and presents a significant market size, however, considerably underperforms in higher education and lifelong learning, an area still requiring significant investment. Innovation is an area the West Midlands (Met country) excels compared to its peers; in particular, business sophistication, which is corroborated by a similar level of progress in technological readiness and innovation to the EU28.

### 2.1.2 Greater Birmingham and Solihull Local Enterprise Partnership (GBSLEP) and Black Country Local Enterprise Partnership (BCLEP) in the UK economy

The annual growth rates of GVA of the Greater Birmingham and Solihull Local Enterprise Partnership (GBSLEP) and Black Country Local Enterprise Partnership (BCLEP) show close similarities to the pattern of the West Midlands' GDP over the twenty years (Figure 4), except for the fact that the economic slow-down in GBSLEP and BCLEP preceded that of the West Midlands by a year (i.e. 2003 vs 2004 and 2011 vs 2012). Moreover, the LEPs individually could not stabilise economic growth since the GFC in 2008 when compared to the UK average.

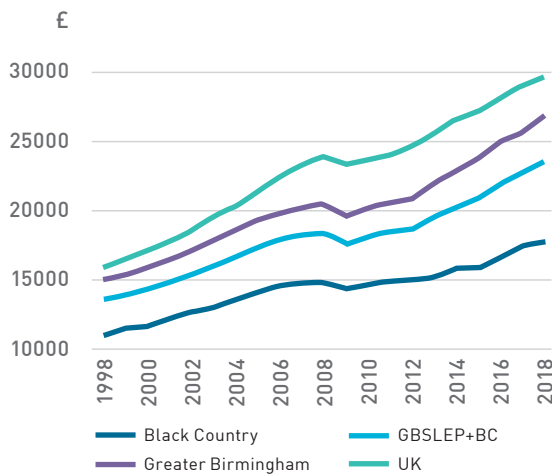
**Figure 4. (a) Gross Value Added, annual growth rate, 1998-2017**



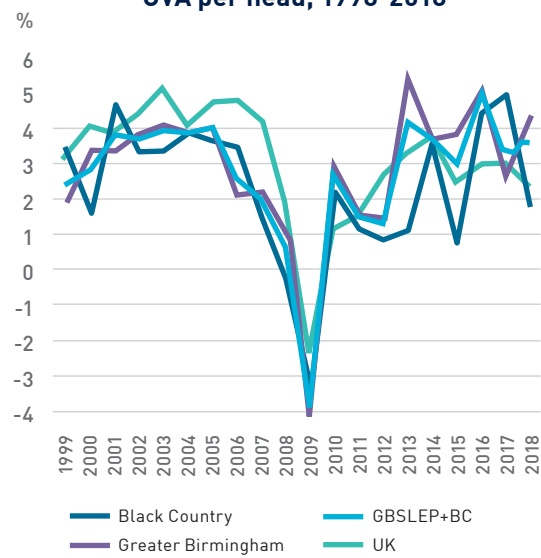
Source: ONS



**Figure 4. (b) GVA per head, 1998-2018**

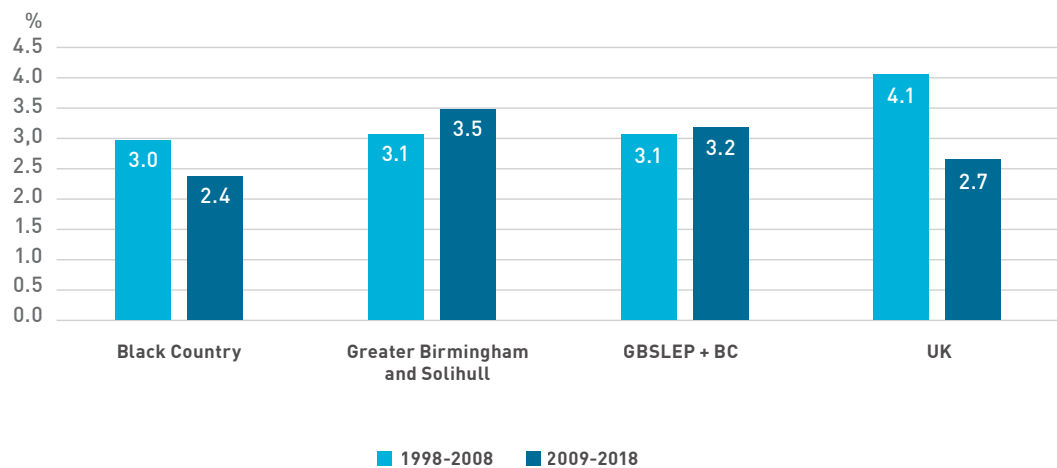


**Figure 4. (c) Annual growth rate of GVA per head, 1998-2018**



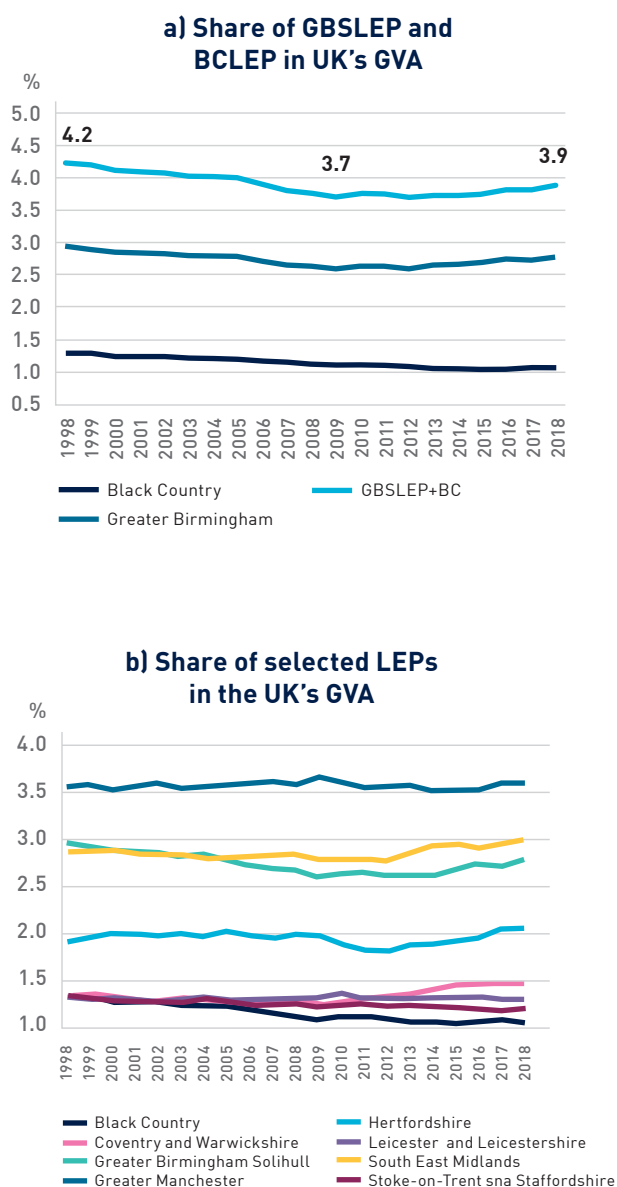
Comparing ten yearly growth rates in GVA per head (with 2008 recession as the cut-off year) depicts: 1. Both LEPs were growing below the UK before the 2008 recession, 2. The UK economy stagnated after the recession, and 3. After the recession, GBSLEP grew more than UK average, while BCLEP did not (Figure 5). A slight improvement in the compound growth rate of GBSLEP after the recession is due to the thriving economic performances of Solihull, Redditch, Tamworth and Cannock Chase (Figure A1). Conversely, the sharp fall in the compound growth rate of the Black Country LEP after the recession is due to the poor economic performance of Wolverhampton (Figure A2).

**Figure 5. Compound annual growth rate of GVA per head, GBSLEP and BCLEP**



Source: ONS

**Figure 6. Share of selected Local Enterprise Partnerships in UK's GVA, %**



Source: ONS

Figure 6 puts the GBSLEP and BCLEP's changing share in the UK's GVA over the last twenty years in perspective. The combined contribution of GBSLEP and BCLEP to the West Midlands' share in the UK's GVA (Figure 6a) displays a similar trend to West Midlands (in Figure 3). The sharp fall to 3.7% in 2009 is likely to account for 0.3 percentage point fall in their share between 1998 and 2018, yet the slight recovery since the 2008 recession is due more to recovery in GBSLEP's share of contribution than BCLEP's low and steady contribution.

Compared to other LEPs (Figure 6b), GBSLEP has lost its competitive position against South East Midlands LEP (SEM LEP) due to its gradually falling share that started with the 1999 recession and lasted until 2005. Despite an increase since 2014, it has not yet caught up with the SEM LEP. The BCLEP is the lowest contributor among all LEPs, starting at 1.3% share in UK's GVA in 1998, falling to 1.07% in 2018.

As shown above, between 2013 and 2018, the West Midlands has shown a successful recovery from the 2008 GFC and presented a buoyant economy until the Covid-19 pandemic unprecedentedly changed the economic environment. In this success, while GBSLEP has played a role, BCLEP remained passive.

In the next section, we will examine the changing industrial structure of the West Midlands over the last twenty years in an attempt to understand its role in the recovery of the West Midlands' economy since the 2008 GFC. Also, to underpin the reasons behind the differences in the contribution of GBSLEP and BCLEP to the then flourishing economy of the West Midlands.





## 2.2. CHANGING INDUSTRY STRUCTURE

### 2.2.1 The Industrial Structure of the West Midlands

The West Midlands is well known for a strong advanced manufacturing base, supported by nationally significant clusters as mentioned in the Midlands Engine Strategy (2017)<sup>7</sup>. Coventry and Warwickshire has the automotive cluster, with an established supply chain for multinational enterprises (such as Jaguar Land Rover, JCB, BMW, General Electric, and Aston Martin). The West Midlands Local Industrial Strategy report (2019)<sup>8</sup> reveals that the region has considerable investment in Connected and Autonomous vehicles (including UK Autodrivedriverless car trial) to meet the challenge of Future Mobility component of Government's Industrial Strategy (2017)<sup>9</sup>. This signals a transformation in its automotive industry and the related supply chain in the near future. The Black Country has an advanced manufacturing cluster. Stoke-on-Trent and Staffordshire has a declining traditional ceramics cluster, which is trying to re-invent itself. Leicester and Leicestershire has a strong agri-food and drinks industry and space research and earth observation centre. Birmingham is gaining competitiveness in life sciences and medical devices in terms of increasing number of medical technology. Malvern is home to cyber security clusters (digital technology) and Leamington Spa and Coventry host the games development clusters; all of which represent a strong science and research base for the West Midland's.

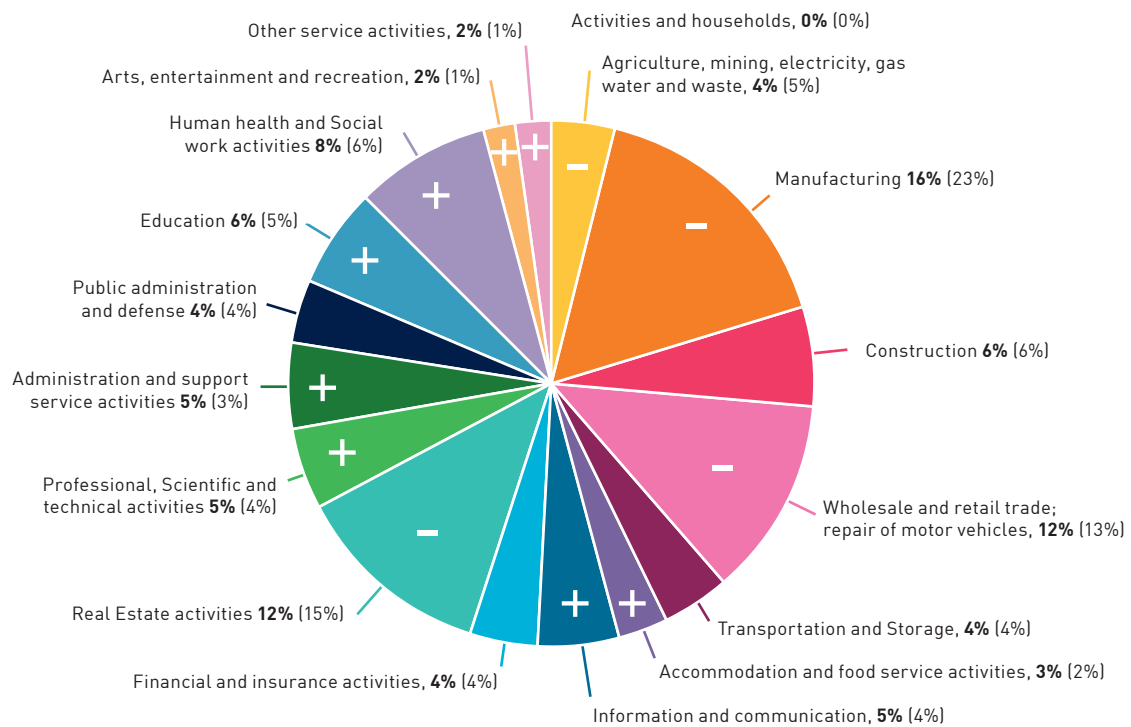
---

<sup>7</sup>[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/598295/Midlands\\_Engine\\_Strategy.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/598295/Midlands_Engine_Strategy.pdf)

<sup>8</sup>[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/802092/west-midlands-local-industrial-strategy-double-page.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/802092/west-midlands-local-industrial-strategy-double-page.pdf)

<sup>9</sup>[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/730043/industrial-strategy-white-paper-print-ready-a4-version.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/730043/industrial-strategy-white-paper-print-ready-a4-version.pdf)

**Figure 7. Distribution of industries in GVA of West Midlands, 2018 % (in comparison to 1998 %)**



**Key:**  
[Sector name, 2018 % (1998 %)] - the first percentage refers to 2018 shares and the percentage in paranthesis refers to 1998 shares.

Source: ONS

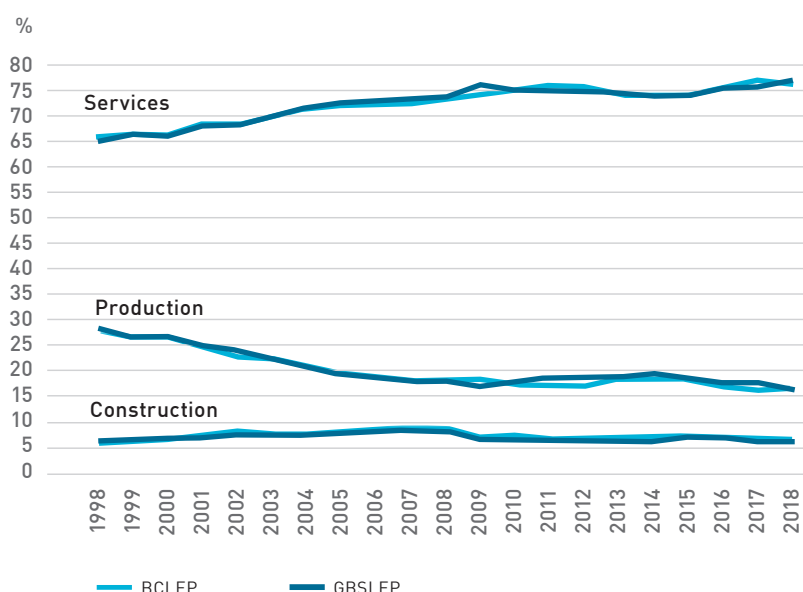
However, although known for its manufacturing strengths, the share of manufacturing in the West Midlands' total industry has fallen from 23% of total GVA in 1998 to 16% in 2018 (Figure 7). In the last twenty years, there has been an obvious shift from the production sector (share decrease from 28% of GVA to 19%) to the services sector (share increase from 66% in GVA to 75%). In particular, in the services sector, education and human health and social work activities have improved 1% and 2% respectively.

## 2.2.2 The Industrial Structure of GBSLEP and BCLEP

The distribution of major sectors in GBSLEP and BCLEP tell a story of their falling GVA shares (Figure 8). In 1998, production accounted for 28.5% of the economy in GBSLEP and BCLEP together; by 2018, this figure dropped to 16.7%. The sharp fall started in 2005, and the 2008 GFC made the government realise the importance of the production sector. This corresponds with the rise within the academic debate of the need for industrial strategy to contribute to regional development (Hudson 2007, Pike et al 2007, Asheim et al. 2011, Bailey et al. 2019). However, the production sector did continue to decline.



**Figure 8. Share of production, services and construction sectors in GBSLEP and BCLEP's GVA**



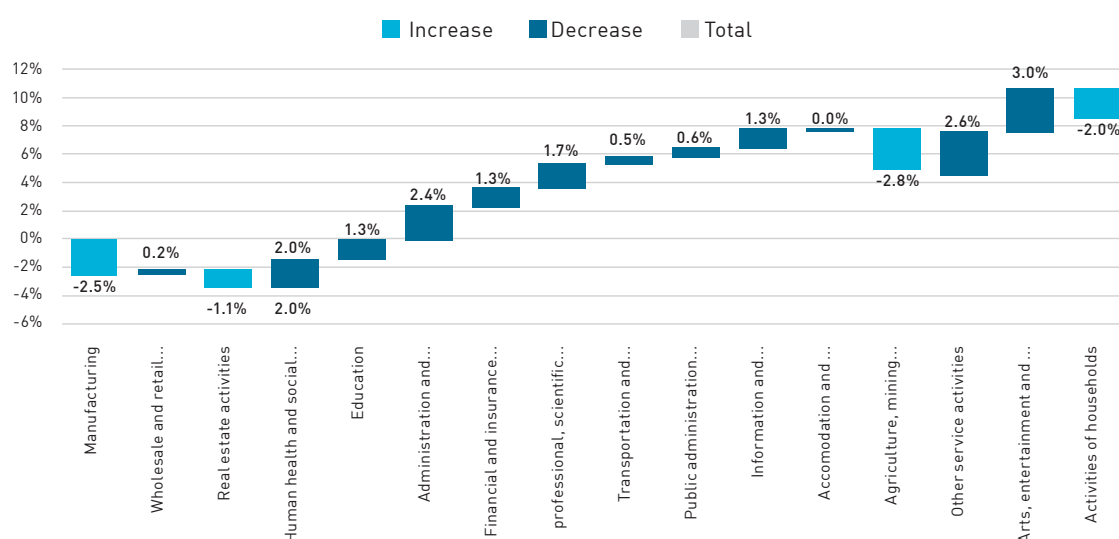
The Construction sector has become an important sector, particularly for the Black Country's economy. The 6% share in 1998 swiftly increased to 9% in 2006 compared to 8% in the GBSLEP's economy, whose share declined sharply over the recession. The sector could not recover from the recession and has only a slightly higher share in 2018 (around 6.5%) than its 1998 value.

Source: ONS

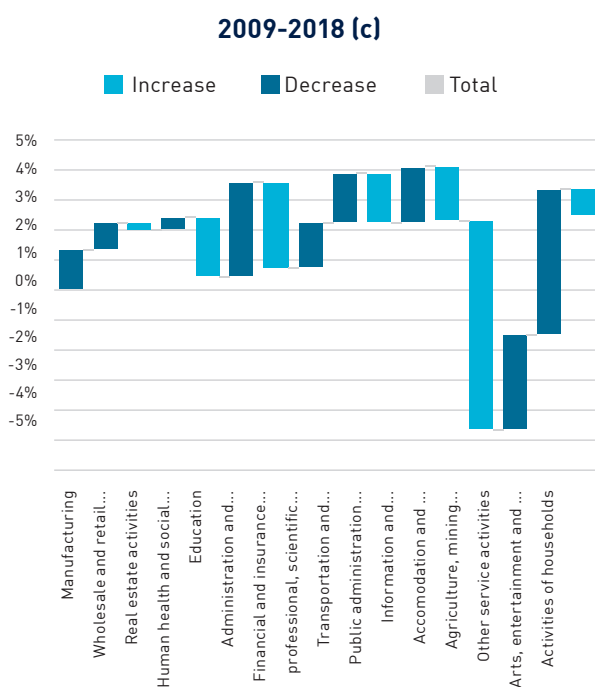
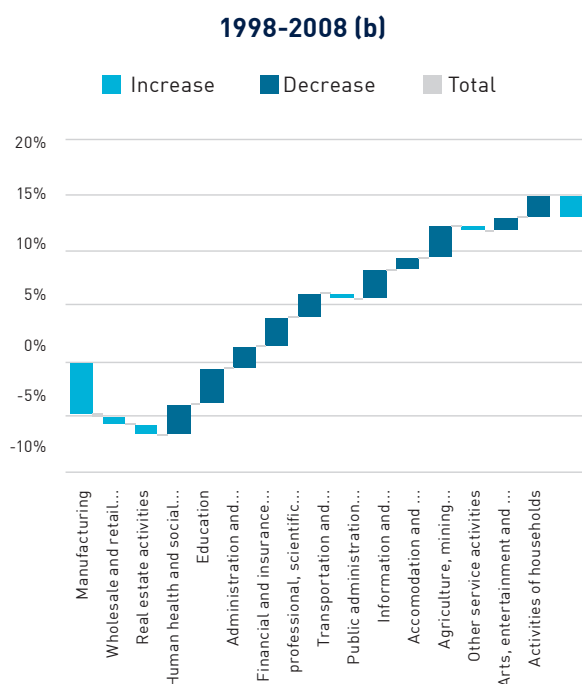
The Services sector accounted for 65% in 1998, and by 2018, its share has improved to a healthy 77%. As opposed to the Production and Construction sectors, the 2008 GFC did not affect the Services sector adversely; instead, it plateaued until 2015, and then took off again.

The ten-yearly growth rates of GBSLEP and BCLEP's industries, calculated on the basis of the changes in their share in total industrial activities (Figure 9, panel a) provides striking and confirmatory evidence on the declining Manufacturing sector (around 10 percentage points or 2.5% average annual decline). The Manufacturing sector was gradually declining over the years, dropping from 24.1% in 1998 to 12.5% in 2009. The sector showed some revival after the recession because of changing regional and national public policies towards manufacturing. Yet it has not recovered to where it was in 1998.

**Figure 9. Annualised growth rates in industries of GBSLEP & BCLEP, 1998-2018 1 (a)**



Source: ONS



Source: ONS

The weakening of manufacturing shadows the 1-2 percentage point improvement in several services sectors' share in total industry, such as professional, scientific and technical services (1.7 percentage point), education (1.5 percentage point), financial and insurance activities (1.3 percentage point), information and communication (1.1 percentage point) and other services (0.9 percentage point). Significant improvement over the last twenty years is apparent in human health and social work activities (3.1 percentage point) and administrative and support services (2.4 percentage point).

The real estate and agriculture sectors in GBSLEP and BCLEP display different patterns of decline between two ten-yearly periods, indicating different reasons behind their fall (Figure 9, panels b and c). The real estate sector is a sector that is susceptible to economic downturns and was affected by both the 1999-2000 recession and 2008 GFC. Agriculture has always been in decline since 1998 (with its humble share of 4.3% in total industrial activities) until the 2008 recession, when it surprisingly revived to a 5% share in 2009 but could not keep the momentum and gradually declined to 2.4% by 2018.

The industrial structure of the West Midlands has clearly changed over the last twenty years in favour of services sector, leaving the region vulnerable during the 2008 GFC. Efforts to revive production through reshaping the manufacturing clusters has gained momentum since then. The next subsection gives a snapshot of the role of SMEs in this changing structure.



### 2.2.3 West Midlands' SMEs by industry

The West Midlands' SMEs have a strong presence in the UK industries. An examination of their share in UK industries indicates the sheer dominance of micro firms with none to 9 number of employees in all industry categories (Table 1). A significant share of small firms also operate in health, manufacturing, wholesale trade, accommodation and food services, and education sectors (in order of highest to lowest share).

**Table 1. Share of West Midlands enterprises in the UK industries, by firm size, 2019**

	micro (0-9)	small (10-49)	medium (50-249)	250+	Total
01-03 : Agriculture, forestry & fishing	8.1	0.2	0.0	0.0	8.3
05-39 : Manufacturing	7.7	1.9	0.5	0.1	10.3
41-43 : Construction	7.0	0.4	0.0	0.0	7.4
45 : Wholesale and retail trade and repair of motor vehicles and motorcycles	9.2	0.7	0.1	0.0	10.0
46 : Wholesale trade; except of motor vehicles and motorcycles	7.8	1.5	0.3	0.1	9.6
47 : Retail trade; except of motor vehicles and motorcycles	7.3	0.6	0.1	0.0	8.0
49-53 : Transport & Storage (inc postal)	11.2	0.6	0.1	0.0	11.9
55-56 : Accommodation & food services	6.1	1.4	0.1	0.0	7.6
58-63 : Information & communication	5.3	0.2	0.0	0.0	5.6
64-66 : Finance & insurance	5.6	0.3	0.1	0.0	5.9
68 : Real estate activities	7.2	0.4	0.0	0.0	7.6
69-75 : Professional, scientific & technical	6.3	0.3	0.0	0.0	6.7
77-82 : Business administration & support services	7.8	0.7	0.1	0.0	8.6
84 : Public administration and defence; compulsory social security	8.2	0.3	0.3	0.3	9.1
85 : Education	6.0	1.1	0.8	0.3	8.1
86-88 : Health	5.7	2.3	0.4	0.1	8.5
90-99 : Arts, entertainment, recreation & other services	6.3	0.6	0.1	0.0	7.1
Total	7.0	0.7	0.1	0.0	7.9

Source: ONS, Business Population Estimates, 2019.

SMEs dominate all of the WM industries (Table 2) and despite this fact, a striking decline from 2010 to 2019 in employment and turnover shares of SMEs is in manufacturing, wholesale and retail trade, information and communication sector, administrative and support services, education, human health and social work.



**Table 2. West Midlands SMEs' distribution in industry, by share in private sector, employment and turnover**

	WM SMEs in the private sector (%)				Employment (%)				Turnover (%)			
	2010	2013	2016	2019	2010	2013	2016	2019	2010	2013	2016	2019
A Agriculture, Forestry and Fishing	100.0	99.9	38.5*	99.7	94.5	85.7	69.6	70.0	71.7	93.8	*	84.1
B, D and E Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply; Sewerage, Waste Management and Remediation Activities	99.4	99.0	99.6	99.6	10.0	11.5	18.4	19.2	-	7.2	6.9	15.8
C Manufacturing	99.5	99.6	99.8	99.6	60.3	58.9	56.4	55.5	42.4	35.2	22.7	24.5
F Construction	99.9	100.0	99.8	99.8	74.9	75.1	88.0	88.4	69.1	59.6	75.6	74.3
G Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles	99.8	99.8	99.9	99.8	54.6	52.4	52.5	50.7	53.8	55.2	50.5	46.1
H Transportation and Storage	99.9	99.9	99.8	100.0	53.1	55.6	56.7	60.5	50.9	50.5	49.9	49.0
I Accommodation and Food Service Activities	99.9	99.9	99.8	99.6	27.8	33.0	31.5	36.6	29.9	28.4	26.7	33.2
J Information and Communication	100.0	100.0	99.5	27.4*	60.5	80.3	80.3	55.0	51.0	68.3	75.2	40.4
K Financial and Insurance Activities	99.8	99.7	99.9	99.8	38.5	46.3	42.1	50.2	-	-	-	-
L Real Estate Activities	99.7	99.8	100.0	99.9	62.9	81.4	82.6	69.8	52.1	74.7	70.5	74.9
M Professional, Scientific and Technical Activities	99.9	99.9	99.9	100.0	75.4	80.2	76.8	83.7	73.8	79.7	65.2	81.5
N Administrative and Support Service Activities	99.8	99.9	99.9	99.8	47.0	38.8	39.7	37.7	61.4	58.6	55.0	45.5
P Education	99.9	100.0	99.9	6.7*	86.9	78.1	80.9	30.3	*	28.9	49.9	38.9
Q Human Health and Social Work Activities	99.7	100.0	13.2*	99.8	74.7	76.0	70.8	65.6	1.1*	70.2	65.7	59.3
R Arts, Entertainment and Recreation	100.0	99.6	100.0	9.5*	72.4	47.5	37.5	36.7	*	2.2*	2.7	25.0
S Other Service Activities	100.0	100.0	100.0	100.0	78.3	74.2	74.2	76.9	56.2	66.2	69.9	53.9

\* refers to presence of data that are deemed to be disclosive, hence not available.

Source: ONS, Business Population Estimates, 2010 – 2019.

A fall in the share of SMEs in the manufacturing sector is in line with the overall decline of manufacturing in the West Midlands' economy, and might be an explanation for BCLEP's falling share in the UK's GVA. Substantiating the increasing share of services in the West Midlands' economy, SMEs in accommodation and food services, and professional, scientific and technical services present an increasing share of employment and turnover during the ten-year period. However, the increasing employment and turnover share of SMEs in real estate and construction sectors actually contribute to the decline of these sectors in the West Midlands' economy. In a similar vein, despite decreasing employment, increasing turnover shares of SMEs in agriculture contributes to this largely declining sector as well. Moreover, while the West Midlands economy has seen a significant improvement in human health and social work sector and administrative and support services sector in the last twenty years, SMEs in these sectors are not particular contributors to the employment and turnover. Despite a significant presence of SMEs in each sector, their contribution to employment and turnover is not necessarily in line with the changes in a particular sector, indicating productivity issues in some sectors.

The next section will examine the statistics of the SME sector in the West Midlands from the perspective of SME growth.







## 3. THE SME SECTOR IN THE WEST MIDLANDS

### 3.1. GENERAL STATISTICS

In 2019, the West Midlands region had a population of around 6 million people and 480,000 businesses in the private sector (both registered and unregistered<sup>10</sup>), comprising 8.2% of the total number of UK businesses (Table 3)<sup>11</sup>. GBSLEP and BCLEP account for around 4% of the West Midlands' share (Figure 11, last cluster)<sup>12</sup>. These businesses employed 2.35 million people, and created £330 billion turnover<sup>13</sup>. Micro firms and SMEs are the backbone of West Midlands' economy, together comprising 99.9% of the total enterprises in the West Midlands, creating 58% of the employment and 44% of the turnover throughout the last ten years (Table 3).

**Table 3. West Midlands, number of enterprises, employment and turnover, by firm size, 2019<sup>14</sup>**

Size of firm (number of employees)	Number of businesses	% in total	Employment	% in total	Turnover (million£)	% in total
None*	362,052	75.5	391,000	16.7	22,445	6.8
1-49	114,130	23.8	696,499	29.7	81,198	24.6
50-249	2,877	0.6	276,710	11.8	41,259	12.5
250+	480	0.1	982,555	41.9	185,171	56.1
Total SMEs	479,039	99.9	1,364,209	58.2	144,902	43.9
Total enterprises	479,539	100	2,346,764	100	330,073	100
% in total UK	8.2		8.5		8.0	

\* None: Self-employed owner-manager(s), and companies with 0 or 1 employees, who are assumed to be employee directors.

Source: ONS, Business Population Estimates, 2019.

Throughout 2017-2019, the share of SMEs in the West Midlands in total UK enterprises slightly decreases every year in all SME sizes (micro, small and medium), while the share of large enterprises steadily increases (Figure 10, fifth cluster). While the combined share of GBSLEP and BCLEP's SMEs present a similar declining pattern during 2017-2019, overall there is a 0.5 percentage points improvement from 2014 to 2019 with strikingly high increases in 2015 and 2017 (Figure 10, fourth cluster). In this period, while the share of micro firms increases, the share of medium firms is in decline.

The major contributor to the growth of SMEs in GBSLEP's share in the total UK SMEs is Birmingham, which has almost the same contribution as that of BCLEP (Figure 10, second and third clusters). BCLEP contains a stable presence in the UK's SME population at 1.2% throughout the five-year period, whose economy is shaped more by small and medium sized enterprises than micro enterprises. Large firms are also an important part of the BCLEP economy.

<sup>10</sup> ONS data includes businesses with no employees, which can either be 'registered' for either VAT and/or PAYE or are 'unregistered'.

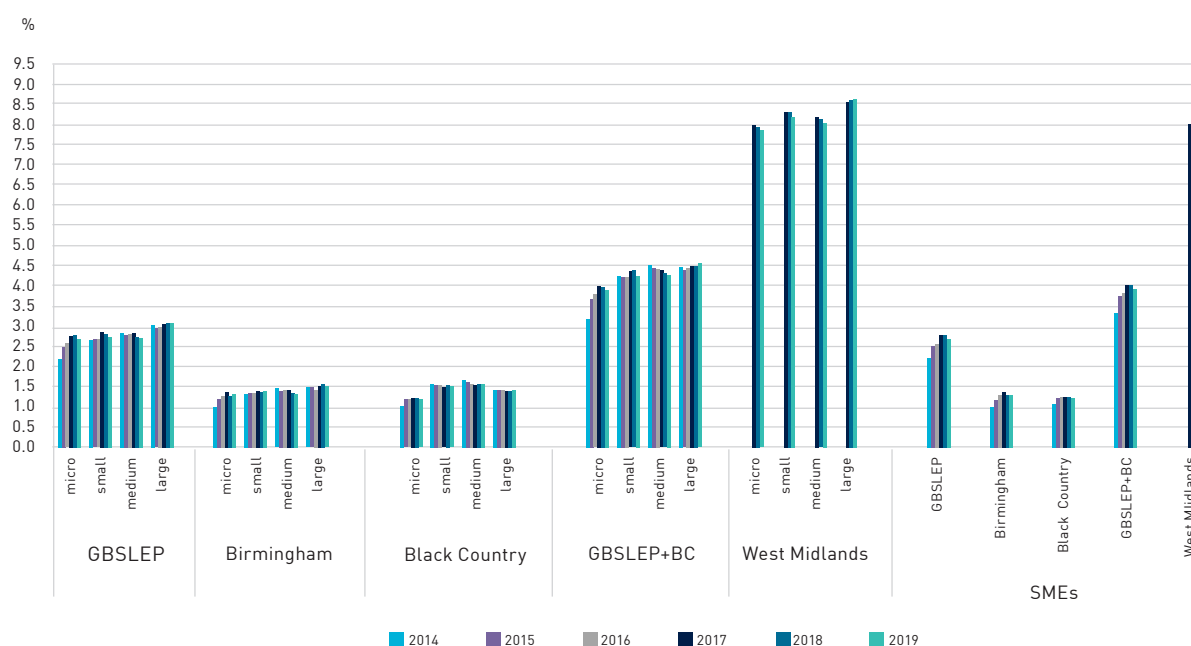
<sup>11</sup> According to ONS UK Business: Activity, Size, Location 2019, 213,915 of these businesses are registered under VAT and/or PAYE, making 55.4% of them being unregistered. Registered businesses comprise 7.9% of the total registered businesses in the UK and 99.6% of them are micro businesses and SMEs.

<sup>12</sup> This value is almost the same as their share in total number of SMEs in UK, since the 99.6% of the enterprises in these LEPs are SMEs during 2014-2019.

<sup>13</sup> ONS (2009) clarifies that data on total turnover exclude SIC 2007 Section K (financial and insurance activities) where turnover is not available on a comparable basis. The turnover of unregistered businesses are imputed by BEIS based on the turnover for zero-employee VAT/PAYE registered businesses at industrial sector level.

<sup>14</sup> ONS rounded the numbers of businesses in order to avoid disclosure, hence totals may not exactly match the sum of their parts.

**Figure 10. Share of number of enterprises in the UK total, 2014-2019, %**



Source: ONS

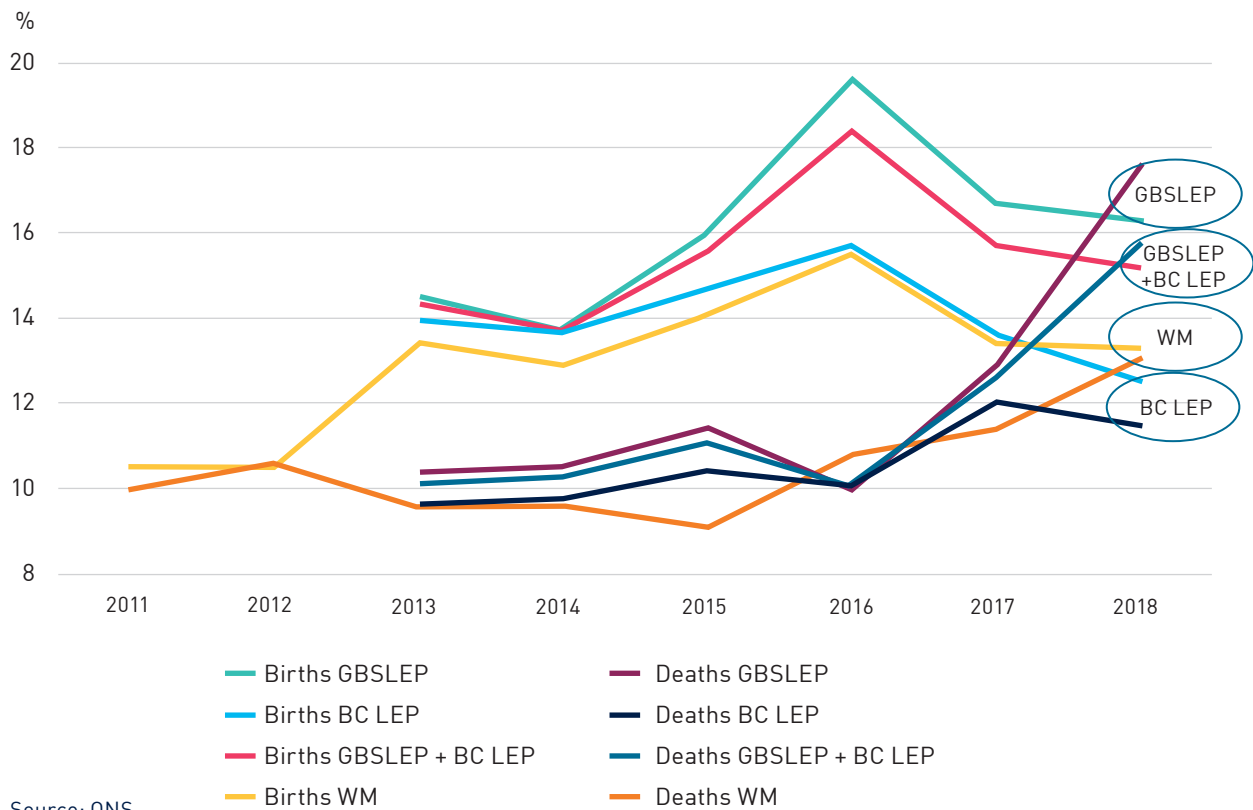
An interpretation of the significant fall in the share of micro and small enterprises in 2019 might lie in the business birth, death and survival rates (Figures 11 and 12). The gap between the rates of business entries and exits has been narrowing since 2017. By 2018, GBSLEP had already more business exits than entries, BCLEP maintained more business entries than exits yet both with a declining trend. The West Midlands, in 2018, approached its narrowest gap between the rates of business entries and exits, indicating a possibility of more exits than entries in the coming years: similar to 2012 when the economy significantly slowed down (see Tables A2, A3). This would be welcome if a possible impact were creative destruction that produced firms that are more productive.<sup>15</sup> We see such effect in GBSLEP's annualised growth rate of GVA during 2013-2018 when the number of active businesses grew annually by 6.8% as compared to the 3.7% UK average (Figure A3). Yet the same cannot be said for BCLEP whose annualised growth rate of GVA fluctuated around the UK average and that of active firms (at 3.6%) fell below the UK average.<sup>16</sup> In addition, Figure 12 suggests that at the end of any five-year period around 40% of the new entrants survive. By 2018, out of the UK firms that were born in 2013, 42.4% of them survived (Figure 12). While West Midlands' firms are slightly above this average, GBSLEP is marginally and BCLEP is noticeably below.

<sup>15</sup> Particularly during times of economic crisis, creative destruction is expected to create an economic renewal after a shock introduced to the economy with increasing productivity levels and living standards. During the financial crisis in 2008, up to 50 companies were closing on a daily basis in the UK (estimated by the Federation of Small Business) (Kirkup, J. 'Financial crisis: 50 small businesses closing each day', 4 November 2008, The Telegraph, <https://www.telegraph.co.uk/finance/financialcrisis/3379487/Financial-crisis-50-small-businesses-closing-each-day.html>; Milner, M. 'Small Business closures hit 280 a week', 23 October 2008, The Guardian, <https://www.theguardian.com/business/2008/oct/23/recession-creditcrunch>).

<sup>16</sup> Low performance of growth rate in the number of active firms was mostly due to the trade-off between the growth performances of businesses in Dudley (1.6%) and Walsall (3.3%) on one hand and Sandwell (5.0%) and Wolverhampton (5.1%) on the other.

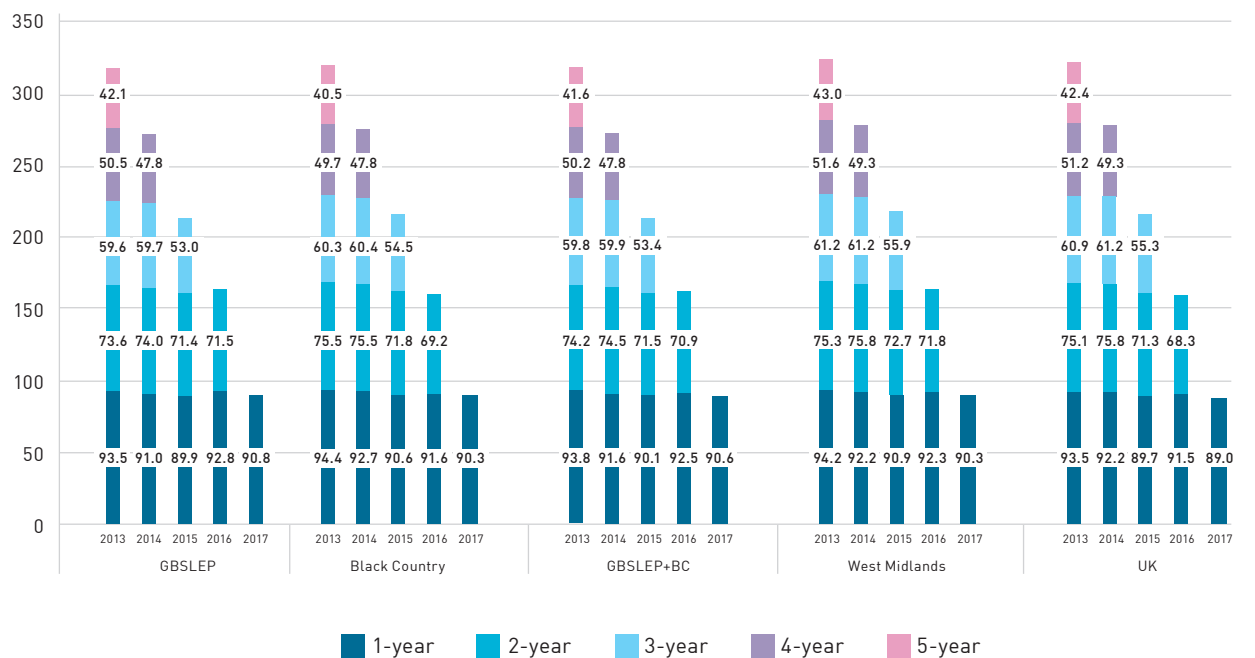


**Figure 11. Business Births and Deaths: GBSLEP, BCLEP, GBSLEP + BCLEP (2013-2018), and West Midlands (2011-2018), % in active enterprises**



These altogether provide yet further evidence for low productivity levels in micro and small firms. To understand the extent of productivity issues in SMEs, the next subsection will look at the level of growth the West Midlands SMEs achieved over the last decade or so.

**Figure 12. Survival rate of newly born enterprises, 2013-2018, %**





## 3.2. SME GROWTH IN WEST MIDLANDS

This section examines whether and to what extent the falling share of West Midlands' SMEs in the UK economy in the last couple years was compensated with high SME growth rates: argued to be the panacea to recessions such as the 2008 GFC and the related productivity problems.

### 3.2.1. Turnover Growth of SMEs

In the West Midlands, in 2017, a total of 19,830 firms turned over £1million to £25 million. Of these 18,475 (93%) are SMEs: 32% (5960 of them) are micro firms, 53% (9820) are small firms and 15% (2695) are medium firms.

**Table 4. Share of firms in the UK, by turnover growth size**

% of firms growing at	2007	2010	2013	2016	2018
<5%	66%	65%	67%	71%	61%
5-20%	14%	14%	13%	12%	17%
>20%	21%	21%	20%	17%	22%

Source: ONS, UK Business: Activity, Size and Location 2019 for 2018 values; 2007-2016 values from Nesta (2017), p.27.

On average, since 2007, 66% of the SMEs in the UK grew less than 5% per annum turnover (Table 4). From 2010, a slow increase peaked at 71% in 2016 and then dropped significantly by 10 percentage points to 61% in 2018. Conversely, SMEs growing 5% to 20% per annum and at greater than 20% per annum saw a steady decline during 2010-2016 and then, with an increase of 5 percentage points, peaked to 17% and 22% in 2018 respectively. This indicates an improvement in the SMEs growth prospects since 2016.

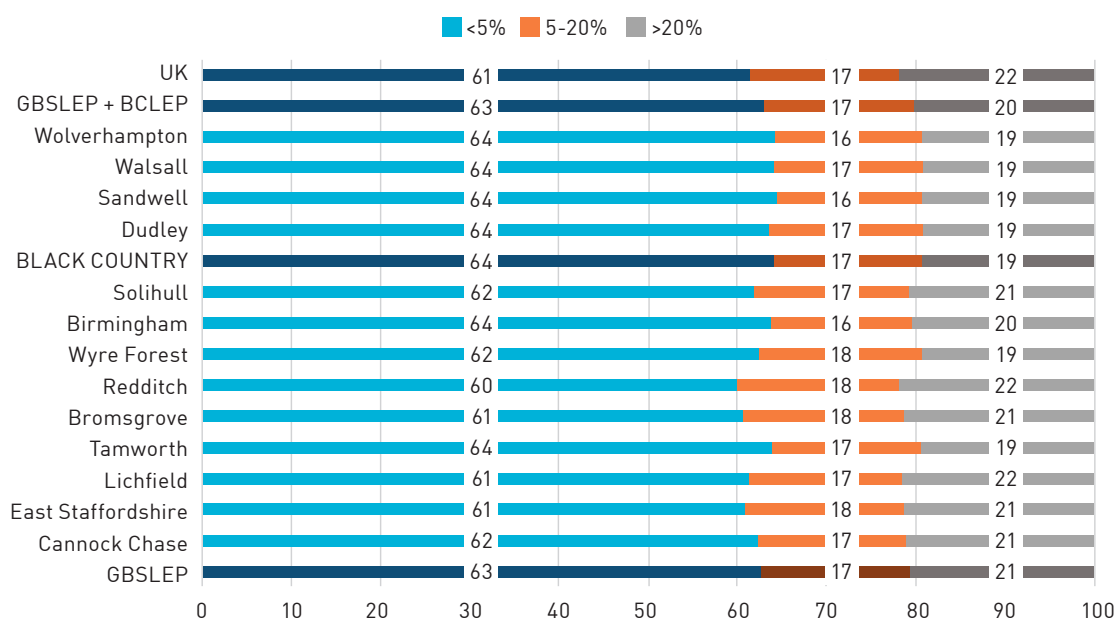
### 3.2.2 High-growth instances

If they have at least 10 employees, the enterprises that are growing at more than 20% in a particular year (not over a three-year period) are called 'high-growth instances'. In 2018, in GBSLEP, high-growth instances (>20%) account for 19% to 22% of the SMEs in each council (Figure 13). Rather than high-growth instances, BCLEP have an increasing number of SMEs that grow less than 5%. GBSLEP closely follow the UK average but is still below it.

Table 5 presents the high-growth instances in the GBSLEP and BCLEP based on their 2017 annual turnover growth rate compared to 2016. In 2017, in each turnover growth category, Birmingham (on average 45%) and Solihull (on average 13%) account for almost 60% of the enterprises in GBSLEP. In BCLEP, 30% of high-growth instances comes from Dudley, followed by Sandwell, Walsall and Wolverhampton. Overall, GBSLEP contributes with 2.4% of high-growth instances in the UK in 2017, together with BCLEP they contribute 3.5%.



**Figure 13. Share of enterprises by turnover growth, GBSLEP and BCLEP, 2018**



Source: ONS 2018

Table 5 displays that in a particular year a significant amount of enterprises are growing steadily (5% to 20%), rather than high growth rates (more than 20%) but even this makes a valuable impact to their business.

**Table 5. Share of enterprises in GBSLEP and BCLEP based on their growth in the previous full year turnover, 2017**

	<5%	5-10%	10-15%	15-20%	>20%	Total
Cannock Chase	5.2	5.1	5.7	4.7	5.3	5.2
East Staffordshire	7.2	7.7	8.2	7.0	7.6	7.3
Lichfield	7.4	7.9	7.7	7.6	7.9	7.6
Tamworth	3.6	3.3	3.7	3.7	3.3	3.5
Bromsgrove	7.1	7.6	8.6	8.1	7.6	7.4
Redditch	4.1	4.0	4.8	6.0	4.5	4.3
Wyre Forest	5.4	6.1	5.9	5.5	5.1	5.4
Birmingham	47.8	46.4	42.2	43.3	46.3	46.9
Solihull	12.3	11.9	13.3	14.1	12.4	12.4
<b>GBSLEP</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
Dudley	29.8	30.2	32.0	31.0	29.9	30.0
Sandwell	25.8	25.5	23.4	26.2	25.7	25.7
Walsall	23.1	23.1	23.8	22.6	23.0	23.1
Wolverhampton	21.2	21.2	20.7	20.2	21.3	21.2
<b>BC LEP</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Share of enterprises in the UK based on their growth in the previous full year turnover, 2017</b>						
GBSLEP	2.60	2.55	2.52	2.55	2.39	2.54
BC LEP	1.27	1.28	1.18	1.12	1.07	1.22
GBSLEP +BCLEP	3.87	3.83	3.70	3.67	3.46	3.76

Source: ONS, March 2018, Analysis showing the count of VAT and/or PAYE based enterprises and live local units in Districts of the United Kingdom with growth in the previous full year turnover by % size band





### 3.2.3 High-growth firms

'High-growth firms' (HGFs) are fast growing firms with 10 or more employees and average annual growth rate of 20% or more (in employment, turnover or in both) over a three-year period. They represented 6% of all firms in the UK between 2005 and 2008, above the OECD average. One third of HGFs in the UK were located in the Greater London and South East regions (Anyadike-Danes et al. 2009, Mason et al. 2009). By 2016, only 1% of the registered enterprises across the UK are HGFs (Nesta 2017).

In the 2014-2017 three-year period, out of 230,100 active firms, the West Midlands had 1010 HGFs in terms of employment growth. GBSLEP and BCLEP together had 530 HGFs in terms of employment growth, with 85,346 employees and producing £7.5bn turnover (Table 6). While they account for 52.5% of the HGFs in the West Midlands in terms of employment, they actually correspond only to 0.23% of the total number of active enterprises in the West Midlands in 2017. From the perspective of turnover growth, 1205 firms achieved 20% turnover growth with 96,388 employees and slightly over £22bn turnover. However, only 265 firms achieved both employment and turnover growth, with 33,135 employees and £3.2bn turnover.

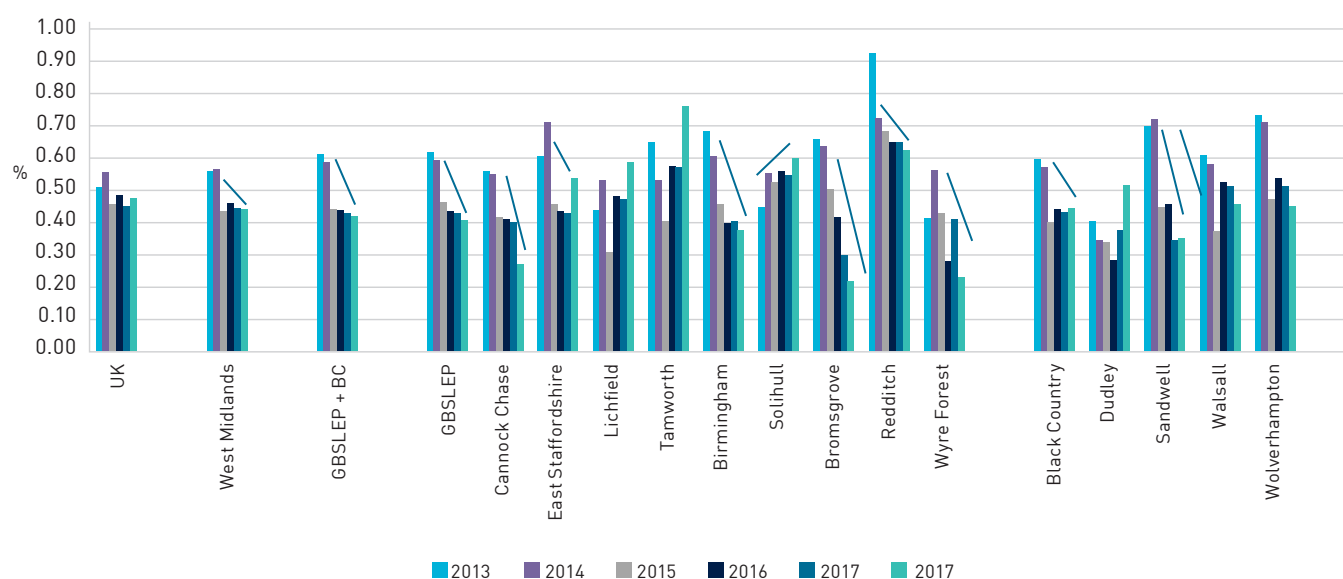
**Table 6. Employment and turnover >20% growth, GBSLEP and BCLEP, 2014-2017**

2014-2017		GBSLEP	BCLEP	GBSLEP+BCLEP
Employment >20% growth	Count	365	165	530
	Employment	71,967	13,379	85,436
	Turnover (£mn)	6,109	1,367	7,476
Turnover >20% growth	Count	810	395	1205
	Employment	66,387	30,001	96,388
	Turnover (£mn)	1,771	4,414	22,184
Both employment and turnover > 20% growth	Count	185	80	265
	Employment	26,859	6,276	33,135
	Turnover (£mn)	2,534	636	3,170

These HGFs are not necessarily operating in high-technology industries. During the 2014-2017 period, firms at top 20% growth in employment and in turnover in GBSLEP are predominantly in human health and social work, administrative and support services and wholesale and retail trade, followed by professional, scientific and technical services, accommodation and food, information and communication, manufacturing and construction.

The falling share of HGFs in the West Midlands since 2014 is a prevalent picture for GBSLEP and BCLEP (except Solihull in GBSLEP and Dudley in BCLEP) (Figure 14). The sharp fall in 2014-2015 is definitive for most of the local authorities in GBSLEP and BCLEP, who have not succeeded in their attempts to revive the share of their HGFs during the past five years. This sharp fall is followed by either a continuing fall in the shares of HGFs (in Bromsgrove, Birmingham, Cannock Chase and Sandwell), or considerable fluctuations year-on-year (in Wyre Forest, Walsall, Wolverhampton), or the shares eventually increase but only to 2013 levels (East Staffordshire) or significantly exceeding (in Lichfield, Tamworth and Dudley). Those with a continuous decrease in the share of HGFs experienced a decrease below the UK average, which is so severe that it is hard to expect any recovery soon. Local authorities that achieved a share of HGFs higher than the UK average by 2018 include Tamworth, Redditch, Solihull, Lichfield, East Staffordshire and Dudley (ordered highest to lowest, 2018).

**Figure 14. Share of HGFs in active firms, 2013-2018**



Source: ONS, Business Demography, 2013-2018

Despite an improvement in the SMEs' growth prospects since 2016, in 2018 both GBSLEP and BCLEP high growth instances perform below the UK average and the picture for high growth firms is neither homogenous nor hopeful for making a difference in the West Midlands economy. Against expectations, more business exits than entries in the West Midlands since 2017 did not lead to more productive firms achieving higher growth rates.

The next section will look closely into the productivity problem in the West Midlands and explain why we identify it as a 'SME drag effect'.

## 4. IDENTIFYING THE 'DRAG EFFECT' OF SMEs ON WEST MIDLANDS' ECONOMY

Our analysis of the secondary data above reveals that despite receiving the biggest blow during the 2008 GFC, the West Midlands', compared to all UK regions, was on track to a healthy recovery prior to the Covid-19 pandemic (Figure 1). Its annual growth rate of GDP was comparable to the UK average up until 2008 GFC. After some turbulence, when compared to the best performing two regions (London and East England), the performance of the West Midlands became more stable after 2012, and eventually converged with their annual growth rate by 2018 at a level above the UK average. When the annualised ten-yearly GDP growth rates of UK regions were compared (1998-2008 vs 2009-2018), overall the UK economy presented a declining trend, whilst the West Midlands was not only among the regions that displayed an increasing trend, but also singled itself out with a dramatic improvement (Figure 2).

As the fifth largest contributor to the UK's GVA by 2018, the West Midlands went through a structural change in its industries over the past twenty years, which affected its contribution to GVA adversely during the 1998-2008 period but improved throughout 2009-2018 (Figures 3-6). Major sectors of manufacturing, agriculture, wholesale and retail trade and real estate were shrinking while services sectors such as arts, human health, education, professional, scientific and technical services were expanding their contribution by 2018 (Figures 7-9).

**Table 7. Distribution of private sector SMEs in West Midlands, and their associated employment and turnover, by their size, 2010 -2019, %**

	Company Size	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>SMEs in the private sector</b>	<b>None</b>	71.3	70.5	72.4	73.8	74.8	73.4	73.9	74.5	73.7	75.5
	<b>1-49</b>	27.9	28.6	26.8	25.3	24.5	25.8	25.3	24.8	25.6	23.8
	<b>50-249</b>	0.7	0.7	0.7	0.7	0.6	0.7	0.7	0.6	0.6	0.6
	<b>Total (0-249)</b>	99.9	99.8	99.9	99.8	99.9	99.9	99.9	99.9	99.9	99.9
<b>Employment</b>	<b>None</b>	14.8	13.7	15.1	15.3	16.2	15.2	15.4	16.3	15.7	16.7
	<b>1-49</b>	33.0	31.7	31.4	30.6	30.4	30.7	30.4	30.9	30.7	29.7
	<b>50-249</b>	12.2	12.7	12.4	12.4	12.1	12.2	12.3	11.9	11.8	11.8
	<b>Total (0-249)</b>	60.0	58.1	58.9	58.3	58.7	58.1	58.1	59.1	58.2	58.2
<b>Turnover</b>	<b>None</b>	7.4	6.9	7.1	6.4	6.6	5.5	6.0	6.9	6.5	6.8
	<b>1-49</b>	30.7	29.3	29.6	27.7	26.1	22.5	23.8	26.4	27.7	24.6
	<b>50-249</b>	14.9	15.3	14.6	14.0	12.7	11.6	12.1	13.1	12.3	12.5
	<b>Total (0-249)</b>	53.0	51.5	51.3	48.1	45.4	39.6	41.9	46.4	46.5	43.9

None: Self-employed owner-manager(s), and companies with 0 or 1 employees, who are assumed to be employee directors.

Source: ONS, Business Population Estimates, 2010 - 2019.

SMEs comprise an important part of the West Midlands economy. To re-iterate, they account for 99.9% of the total enterprises in the West Midlands and contribute to 58% of the employment and to 44% of the turnover (Table 7). However, the share of West Midlands SMEs in total UK enterprises was 8% in 2017-2019 (Table 3) with a decreasing trend in all SME sizes (micro, small and medium) (Figure 10).







There were more business exits than entries particularly in 2018 (Figure 11), leading to an overall shrinkage of SMEs within GBSLEP and BCLEP as well as the overall West Midlands in 2019. This was expected to generate the more productive enterprises. Yet, this impact was not observed. Not only did the 6% high growth performers in the UK economy just before the 2008 GFC shrink to less than 1% by 2016, there was also a sharp decrease of HGFs in GBSLEP and BCLEP enterprises since 2014 (Figure 14).

A closer look at the contribution of SMEs to employment and turnover in the last ten years in the West Midlands' economy sheds light on a deeper issue of low productivity. While SMEs' share in employment stayed around 58-59% from 2011 to 2019, their share in turnover fell sharply from 53% in 2010 to around 40% in 2015 (Table 7, Total (0-249) rows). Even though it gained slight momentum (4 percentage points or 11% increase) towards 2019, overall, it is a 17.2% drop in the share of SMEs in total UK turnover within a space of ten years.

Table 7 categorises firms into three as sole trader (with one or no employees), micro and small enterprises (1-49 employees), and medium sized enterprises (50-249 employees). Since this is the only available data by ONS that details the employment and turnover values of SMEs this firm categorisation does not allow us to distinguish the effects on micro (0-9 number of employees) and small (10-49 employees) enterprises, but treat it as one.

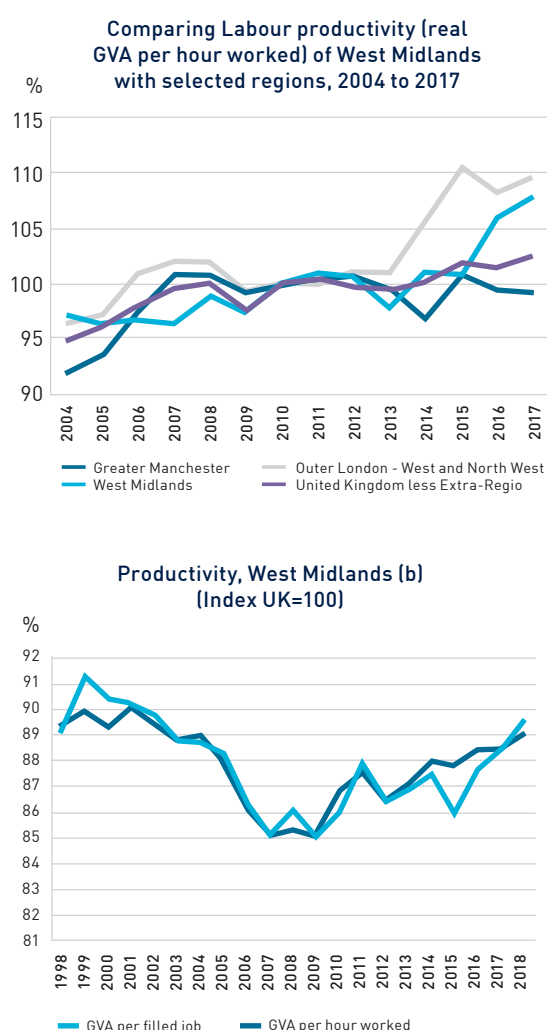
Sole trader businesses with no or one employee (None category in Table 7) largely represent the self-employed. Over the last decade, sole trader firms have an increasing presence within the SMEs sector, accounting for on average 74% of the West Midlands SMEs. They display falling turnover share accompanied with an increasing contribution to employment. These trends in their share of employment and turnover signal their growth over a decade in terms of size but not economic effect.

The share of micro and small enterprises (with 1 to 49 number of employees) in the West Midlands' private sector ranges between 24-29% in the last ten years. Yet, their presence within the SMEs sector shows a declining trend with a loss of 4 percentage points from 2011 to 2019 indicates their struggle to remain in business. While their share of employment in the economy stayed the same around 30% over the last decade, their share of turnover fluctuated, with a drastic fall from 2014 to 2015 followed by a recovery from 2016 to 2018 before falling again in 2019 well beyond the levels in early 2010s.

Medium-sized enterprises with 50 to 249 employees correspond to 0.6-0.7% of the total West Midlands' SMEs. Despite their small percentage in the private sector of the West Midlands, their share by turnover is double that of the sole trader enterprises. Their story is similar to the micro and small enterprises. Their share in employment has been stable around 12% throughout the last ten years. In 2014-2015, they experienced a drastic fall in their share of turnover, which is gradually picking up during the last four years. Nevertheless, overall there has been a 16% decline in their share in total turnover in the West Midlands from 2010 to 2019.

We observe a relationship of employment share increasing or staying the same while turnover share drastically declines in the West Midlands' SMEs. This relationship points out SMEs actually experiencing a 'survival economy' in the last ten years when West Midlands' economy is/was on a healthy path of growth and causing SMEs to create a drag force that prevents the overall West Midlands economy from reaching its full potential. This is similar to a phenomenon in physics called the 'drag effect', best observed in airplane flights. A plane flying forward in the air enjoys an upward-lift force facilitated by the air moving over and under its wings, but at the same time, it experiences a drag force that pushes the plane backwards and slows it down. This closely represents the productivity problem in the SME sector in the West Midlands.

**Figure 15. Productivity, West Midlands**



Source: ONS

Although, UK productivity levels were healthily stabilised around a growth rate of 2.3% a year since 1970 (Jones, 2016), since 2008 the whole UK economy has been suffering from low productivity<sup>17</sup>. This 'productivity puzzle' refers to zero-productivity growth in labour productivity for an extended period. For unknown reasons, which academics still debate, while other countries have managed to rectify it, soon after the economic downturn, as was predicted (Pryce 2015), the UK is still in the grips of it.<sup>18</sup> The West Midlands' economy is not isolated from the overall productivity problem of the UK (WMCA 2017), more importantly it has shown significant improvements in the last five years (Figure 15).

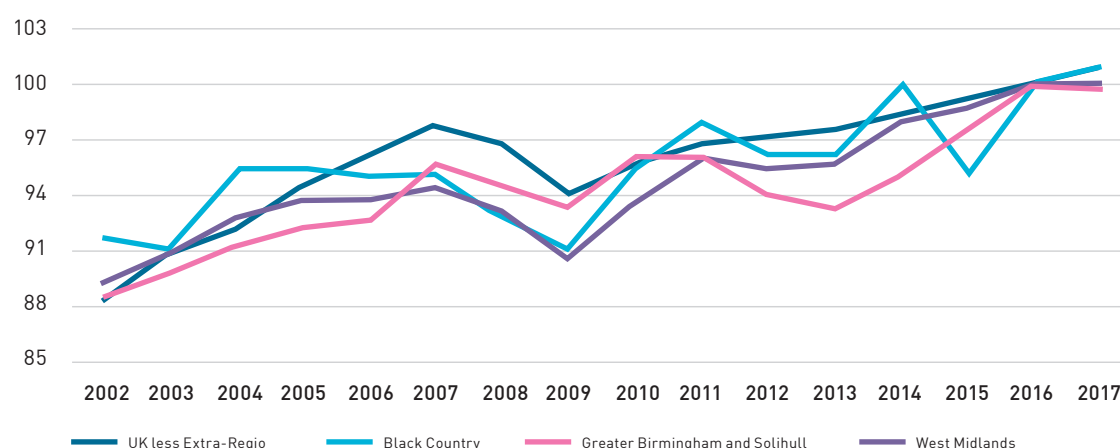
Surprisingly, since 2013, while regional disparities in productivity levels prevail (NESTA 2017), the West Midlands' productivity levels are better than Greater Manchester and the overall UK average, almost catching up with those of Outer London (Figure 15a). Despite a sharp decline during the 2008 GFC, the region had also caught up with the 1998 productivity figures by 2018 (Figure 15b).

There is, however, variation in productivity levels of local authorities in the West Midlands (Figure 16). BCLEP shows an oscillated performance in productivity in the last 15 years, indicating an instability in its productivity levels, which cannot be directly associated with economic recessions. During the 2008 GFC, its productivity levels dipped down as badly as that of the overall West Midlands, yet it managed the downturn in 2012-2013 better than GBSLEP. However, when GBSLEP and the overall West Midlands productivity levels were on a healthy recovery after 2013, BCLEP's productivity level fell back to 2007 level. Since 2016, BCLEP's productivity levels are on the same increasing path as the UK. The GBSLEP, on the other hand, followed a similar trend to the UK productivity levels until 2008, although somewhat below them. The region was not as affected as the BCLEP and overall West Midlands from the GFC. Yet, at a time when the economy started to normalise in 2013, the overall productivity levels of the West Midlands inexplicably recede back to 2009 levels. Since then there is an enormous catching up achieved by the region (4 percentage points), which seems to be relatively stabilised.

<sup>17</sup> Having said that, it is argued that the productivity slowdown actually started 15 years ago and may even go back to before the 1970s (Mullan 2017, 2019).

<sup>18</sup> For instance, for the first time since 1998, the UK death rates overtook birth rates for about three years (2009-2011), and yet the expected creative destruction did not happen. UK productivity levels did not gain the momentum expected, and were indeed stuck at such low levels that it was extremely concerning.

**Figure 16. Productivity (Real (unsmoothed) GVA per filled job indices) 2002 - 2017, 2016=100**



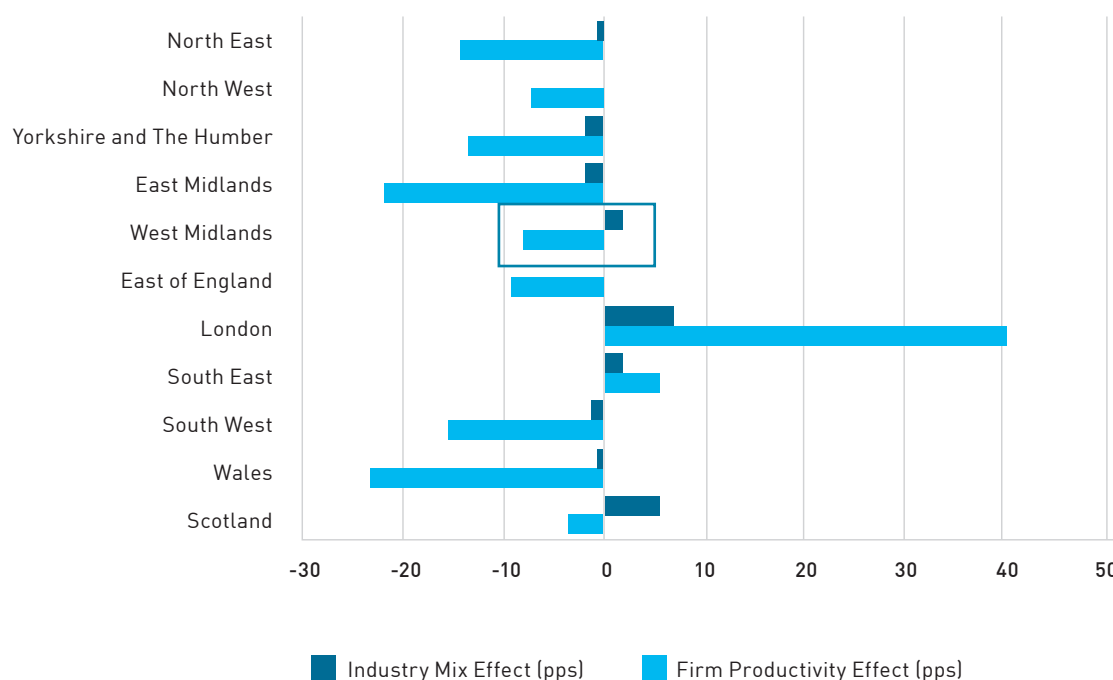
Source: ONS

For some reason, the two local authorities within the same region produced different patterns of productivity levels after 2008 GFC. Our detailed secondary data analysis has indicated an SME productivity problem developing in the West Midlands, and these different patterns in individual local authorities might be closely related to the differences in their industrial structure, in the characteristics of SMEs and in the targeted SME policies.

Moreover, when we considered the usual suspects for low productivity, they did not fully explain the West Midlands' SME productivity problem. Presuming the decline in SME turnover might be an expected outcome of the financial crisis due to a sharp fall in aggregate demand at both national and global markets, even in the short term, does not fit the story. The figures relate to 6 to 7 years after the recession, by then the businesses had begun to recover from the direct effects of the recession, and clearly, the West Midlands' economy had already started to grow.

Labour hoarding, another theory for understanding the productivity puzzle, suggests that firms prefer to keep their employees during uncertain times rather than bearing the cost of employing new workers or dismissing the old ones in the short-run. Although 1.7 million new jobs added to the UK private sector in 2012-2015 (Pryce 2015), Rubery (2013) argues that this is more to do with the growth in zero-hour contract jobs and the UK's so-called flexible labour market than SMEs per se. According to ONS data, the share of employment created by the West Midlands SMEs is actually higher soon after the recession in 2010-2011, which might have been a short-run response to cyclical fluctuation as it is followed by a slight decline in 2012-2013, and is then stabilised fairly soon until 2019.

**Figure 17. Regional Productivity assessed through firm-productivity and industry mix effects, 2015**



Source: ONS, (2018a) Regional firm-level productivity analysis for the non-financial business economy, Great Britain: April 2018.

An ONS (2018a) study investigating labour productivity in regions based on Firm Productivity Index and Industry Composition Index provides the most plausible explanation to the source of the SME drag effect (Figure 17).<sup>19</sup> The study found that differences in firm-level productivities explain differences in productivity across the regions more than by the changes in the local industry structure. According to this study, the only region that displays a contrasting relationship between industry structure and firm productivity is the West Midlands. In 2015, while the changes to the industry structure positively affect the productivity level of the region, it is not large enough to compensate for the effect of the relatively low average productivity levels of the firms located in this region.

Our findings confirm that the shift from production to services sector in the last twenty years might have contributed to improving the West Midlands' economy, but in terms of productivity, the outcome is not so conclusive. For instance, in the service sector, we observe either increasing or decreasing share of SMEs in both employment and turnover. In contrast, declining sectors such as agriculture positively contribute to the region's productivity, because of increasing share of turnover despite sharply declining employment. This indicates a sectoral shift towards the use of advanced technology or the absorption of new technological capabilities by firms to improve productivity (Table 1). The latter is related directly to firm productivity.

<sup>19</sup> In the ONS study (2018a:5), the Firm Productivity Index is created to show "the average level of productivity in a region (relative to the national average) assuming the industry composition in that region is the same as for the economy as a whole; this is designed to demonstrate the effect of the firm level productivities on the region's estimated average aggregate productivity" and the Industry Composition Index is created to show "the average level of productivity in a region (relative to national average) assuming the productivity of each industry in that region equals nationwide average productivity for that industry; this is designed to demonstrate the effect of the industry composition on the region's estimated average aggregate productivity".



Overall, our analysis shows that in the last five years, despite the rosy picture of a burgeoning West Midlands economy since the 2008 GFC, the SME economy in the West Midlands has been less productive than it could have been. A deepening/acute productivity problem in micro and small enterprises more than any other firm category (Table 7) creates a drag effect on the West Midlands economy. While the means to improve productivity is sought through exclusive policies targeting HGFs, following the sharp fall in 2015, the share of HGFs in the GBSLEP and BCLEP continues to fall as opposed to a recovery as would be expected from the special attention these firms received (Figure 14). High-growth instances (>20% growth annually) in the GBSLEP and BCLEP did not present any distinguishing feature from the enterprises that grow 5-20% annually to invest special attention solely to them in SME support programmes (Tables 5 and 6). The West Midlands share of HGFs are still below the UK average and fluctuating from year to year without ensuring a steady impact on productivity, as would be expected from HGFs. The ONS (2018b) study results on low firm productivity in West Midlands (Figure 17) might be taken as an indication that policies targeting HGFs are not as effective as expected. Shifting attention to SMEs that grow 5-20% annually or over the three years might yield better results for reducing the SME drag effect.

The secondary data guides us to some extent. Yet, it leaves us with questions that we are not able to answer, questions that require deeper knowledge of the businesses. Every company has its own idiosyncratic characteristics, even more so in the case of SMEs. The potential drag effect of SMEs in a thriving West Midlands economy can be understood better if we ascertain what drives, or hinders, the growth of SMEs by consulting the SMEs on their operations and opinion.







## 5. CONCLUSION

In this report, we highlighted how the SME economy is potentially creating a 'drag effect' on the buoyant economy experienced by the West Midlands in the last five years. We identified the backdrop for this phenomenon by examining twenty years of key economic data on West Midlands in general, and GBSLEP and BCLEP in particular. We examined the impact of shift in the local industry structure, the various aspects of SME contribution to the region's economy and displayed how productivity problem lies within the SME sector, dragging an economy that is capable of

thriving against all odds. The finding of this report is timely for the West Midlands, as it is crucial to build on the knowledge of the strengths and weaknesses of its economy at these difficult times of Covid-19 pandemic. To deal with the problems emerged by the pandemic in SME economy, it has become even more vital to understand the economic drawbacks the region was experiencing before the Covid-19 pandemic, if robust and sustainable solutions to the problems of West Midlands SMEs are to be developed.

This report will be followed by two complementary reports. In report 2, based on our own diagnostic survey, we conduct a comprehensive analysis of the actual growth experience of the West Midlands SMEs by breaking down SME growth issues into many components. In report 3, we introduce a new integrated framework to advise on overcoming the pressing issues in SME growth that we uncovered in our empirical analysis in report 2, with which we also aim at easing the difficulties SMEs are going through during the Covid-19 pandemic.

# REFERENCES

- Annoni, P. and L. Dijkstra, 2019, The EU Regional Competitiveness Index 2019, European Union, 2019.
- Anyadike-Danes, B.C.-M., Gottschalk, S., Hölzl, W., Johansson, D. and Myrann, A. (2013), "Accounting for job growth: disentangling size and age effects in an international cohort comparison", HUI Working Paper No. 84, HUI Research, Stockholm.
- Asheim, B., Boschma, R., & Cooke, P. (2011). Constructing regional advantage; platform policies based on related variety and differentiated knowledge bases. *Regional Studies*, 45(7), 893–904.
- Bailey, D., C. Pitelis, & P.R. Tomlinson (2019), Strategic management and regional industrial strategy: cross-fertilization to mutual advantage. *Regional Studies*, <https://doi.org/10.1080/00343404.2019.1619927>
- Jones, R. (2016). Innovation, research and the UK's productivity crisis. The University of Sheffield. Sheffield Political Economy Research Institute, SPERI Paper No. 28, April 2016.
- Hudson, R. (2007) Regions and Regional Uneven Development Forever? Some Reflective Comments upon Theory and Practice, *Regional Studies*, 41:9, 1149-1160.
- H&M Revenue Industrial Strategy. (2017). White Paper. [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/730043/industrial-strategy-white-paper-print-ready-a4-version.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/730043/industrial-strategy-white-paper-print-ready-a4-version.pdf)
- Midlands Engine Strategy (2017). [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/598295/Midlands\\_Engine\\_Strategy.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/598295/Midlands_Engine_Strategy.pdf)
- Mullan, P. (2017). *Creative Destruction, How to Start an Economic Renaissance*, Policy Press, Bristol University Press.
- Mullan, P. (2019). *Beyond the zombie economy: The British state is propping up too many unprofitable businesses and perpetuating the economic crisis*, published by Spiked, 21 October 2019, <https://philmullan.com/beyond-the-zombie-economy/>
- Nesta (2017). *The State of Small Business, Putting UK Entrepreneurs On The Map*, October 2017, Nesta and Sage.
- Office for National Statistics. (2009) *UK Standard Industrial Classification of Economic Activities 2007 (SIC 2007)*, Structure and explanatory notes, L. Prosser (ed.), Palgrave Macmillan.
- Office for National Statistics. (2018a), 'The regional firm-level productivity analysis for the non-financial business economy, Great Britain, April 2018'
- Office for National Statistics. (2018b), 'Labour productivity: region by industry'
- Pike A., A. Rodríguez-Pose & J. Tomaney (2007) What Kind of Local and Regional Development and for Whom?, *Regional Studies*, 41:9, 1253-1269.
- Pryce, V. (2015). Why should we care about productivity?. *National Institute Economic Review*, 231 (1): R30-R35
- Rubery, J. 2013, Zero-hour contracts: The darkest side of flexible labour markets, *the Conversation*, 30 July 2013, <https://theconversation.com/zero-hour-contracts-the-dark-side-of-flexible-labour-markets-16500>
- West Midlands Local Industrial Strategy Report. (2019). [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/802092/west-midlands-local-industrial-strategy-double-page.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/802092/west-midlands-local-industrial-strategy-double-page.pdf)
- West Midlands Combined Authority, 2017, *Report of the West Midlands Productivity and Skill Commission*. <https://www.wmca.org.uk/media/2407/ps-commission-final-report.pdf>

# APPENDIX

**Table A1. The classifications of West Midlands used in this report**

West Midlands (NUTS2) sub-regions	Councils
Herefordshire, Worcestershire and Warwickshire	
Shropshire and Staffordshire	Birmingham, Solihull, Coventry, Dudley, Sandwell, Walsall and Wolverhampton
Midlands (Met County)	

GBS LEP	BCLEP
Birmingham, Solihull Cannock Chase, East Staffordshire, Lichfield, Tamworth, Bromsgrove,	Dudley, Sandwell, Walsall and Wolverhampton

West Midlands (ONS data)	Councils
County of Herefordshire	
Stoke-on-Trent	
Telford and Wrekin	
Warwickshire	North Warwickshire, Nuneaton and Bedworth, Rugby, Stafford-upon-Avon, Warwick
West Midlands (Met county)	Birmingham, Solihull, Coventry, Dudley, Sandwell, Walsall and Wolverhampton
Worcestershire	Bromsgrove, Malvern Hill, Redditch, Worcester, Wychavon, Wyre Forest
Staffordshire	Cannock Chase, East Staffordshire, Lichfield, Newcastle-under-Lyme, South Staffordshire, Stafford, Staffordshire Moorlands, Tamworth

**Table A2. Business Birth and Death Rates in West Midlands, 2011-2018**

Business birth and death rates, West Midlands		2011	2012	2013	2014	2015	2016	2017	2018
<b>Births</b>	count (thousands)	20	20	26	26	29	35	31	31
	rate in active firms in West Midlands (%)	10.5	10.5	13.4	12.9	14.1	15.5	13.4	13.3
<b>Deaths</b>	count (thousands)	19	20	18	19	19	24	26	31
	rate in active firms in West Midlands (%)	10.0	10.6	9.6	9.6	9.1	10.8	11.4	13.1
<b>Active</b>	count (thousands)	187	187	192	199	208	224	230	236
	rate in active firms in West Midlands (%)	8	7.9	7.8	7.8	7.8	7.9	7.9	8

Note: Counts given to the nearest thousand)

**Table A3. Births, Deaths and Active Enterprises, GBSLEP and BCLEP, 2013-2018**

GBSLEP	2013	2014	2015	2016	2017	2018
<b>Births</b>	<b>9,550</b>	<b>9,375</b>	<b>11,630</b>	<b>16,070</b>	<b>14,345</b>	<b>14,855</b>
% in active firms in GBSLEP	14.5	13.8	16.0	19.6	16.7	16.3
annual growth rate of births		-1.8	24.1	38.2	-10.7	3.6
<b>Deaths</b>	<b>6,830</b>	<b>7,185</b>	<b>8,285</b>	<b>8,175</b>	<b>11,100</b>	<b>16,060</b>
% in active firms in GBSLEP	10.4	10.5	11.4	10.0	12.9	17.6
annual growth rate of deaths		5.2	15.3	-1.3	35.8	44.7
<b>Active</b>	<b>65,655</b>	<b>68,120</b>	<b>72,580</b>	<b>81,790</b>	<b>85,990</b>	<b>91,110</b>
% in active firms in GBSLEP+BC	67.2	67.1	67.5	68.6	69.1	70.4
% in total UK	2.68	2.67	2.72	2.89	2.94	3.10
annual growth rate of active firms		3.8	6.5	12.7	5.1	6.0



**Table A3. Births, Deaths and Active Enterprises, GBSLEP and BCLEP, 2013-2018**

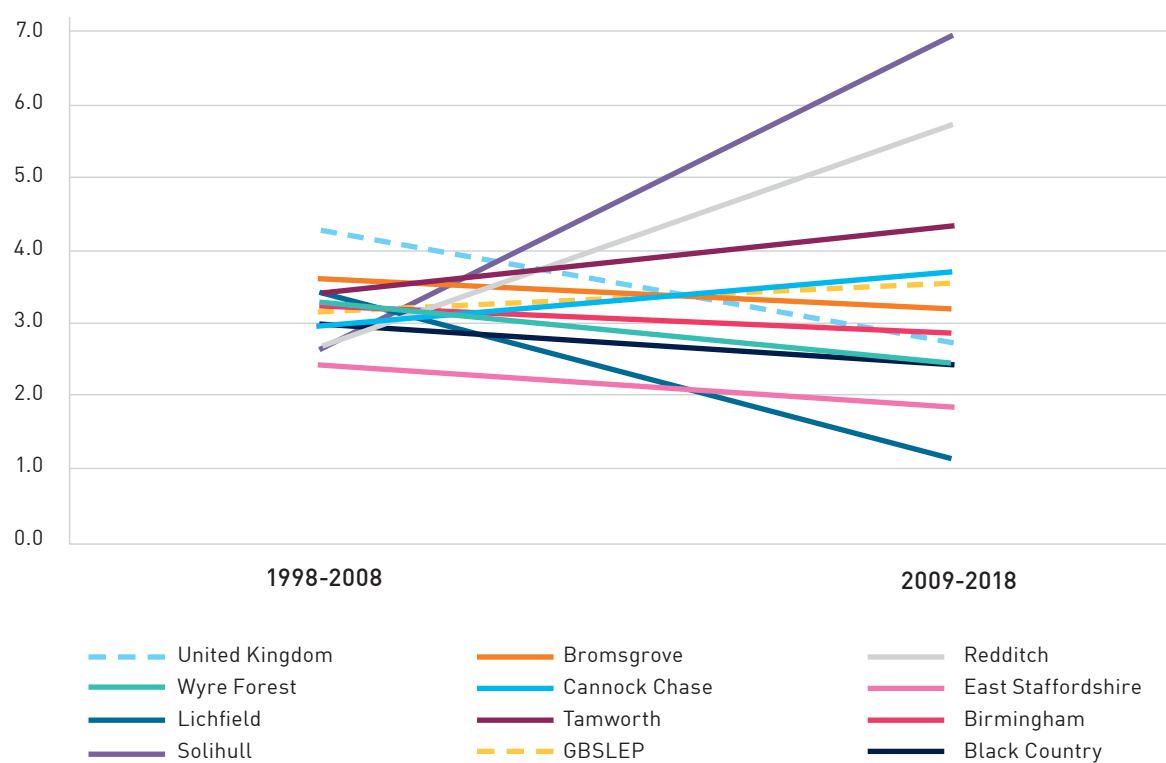
<b>GBSLEP</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>Births</b>	<b>9,550</b>	<b>9,375</b>	<b>11,630</b>	<b>16,070</b>	<b>14,345</b>	<b>14,855</b>
% in active firms in GBSLEP	14.5	13.8	16.0	19.6	16.7	16.3
annual growth rate of births		-1.8	24.1	38.2	-10.7	3.6
<b>Deaths</b>	<b>6,830</b>	<b>7,185</b>	<b>8,285</b>	<b>8,175</b>	<b>11,100</b>	<b>16,060</b>
% in active firms in GBSLEP	10.4	10.5	11.4	10.0	12.9	17.6
annual growth rate of deaths		5.2	15.3	-1.3	35.8	44.7
<b>Active</b>	<b>65,655</b>	<b>68,120</b>	<b>72,580</b>	<b>81,790</b>	<b>85,990</b>	<b>91,110</b>
% in active firms in GBSLEP+BC	67.2	67.1	67.5	68.6	69.1	70.4
% in total UK	2.68	2.67	2.72	2.89	2.94	3.10
annual growth rate of active firms		3.8	6.5	12.7	5.1	6.0

<b>BCLEP</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>Births</b>	<b>4,485</b>	<b>4,570</b>	<b>5,145</b>	<b>5,895</b>	<b>5,240</b>	<b>4,810</b>
% in active firms in BC	14.0	13.7	14.7	15.7	13.6	12.5
annual growth rate of births		1.9	12.6	14.6	-11.1	-8.2
<b>Deaths</b>	<b>3,105</b>	<b>3,265</b>	<b>3,650</b>	<b>3,770</b>	<b>4,650</b>	<b>4,415</b>
% in active firms in BC	9.7	9.8	10.4	10.1	12.1	11.5
annual growth rate of deaths		5.2	11.8	3.3	23.3	-5.1
<b>Active</b>	<b>32,085</b>	<b>33,385</b>	<b>34,950</b>	<b>37,485</b>	<b>38,505</b>	<b>38,335</b>
% in active firms GBSLEP+BC	32.8	32.9	32.5	31.4	30.9	29.6
% in total UK	1.3	1.3	1.3	1.3	1.3	1.3
annual growth rate of active firms		4.1	4.7	7.3	2.7	-0.4

<b>GBSLEP+BC</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>Births</b>	<b>14,035</b>	<b>13,945</b>	<b>16,775</b>	<b>21,965</b>	<b>19,585</b>	<b>19,665</b>
% in active firms in WM (GBSLEP+BC)	14.4	13.7	15.6	18.4	15.7	15.2
annual growth rate of births		-0.6	20.3	30.9	-10.8	0.4
<b>Deaths</b>	<b>9,935</b>	<b>10,450</b>	<b>11,935</b>	<b>11,945</b>	<b>15,750</b>	<b>20,475</b>
% in active firms in WM (GBSLEP+BC)	10.2	10.3	11.1	10.0	12.7	15.8
annual growth rate of deaths		5.2	14.2	0.1	31.9	30.0
<b>Active</b>	<b>97,740</b>	<b>101,505</b>	<b>107,530</b>	<b>119,275</b>	<b>124,495</b>	<b>129,445</b>
% in total UK	4.0	4.0	4.0	4.2	4.3	4.4
annual growth rate of active firms		3.9	5.9	10.9	4.4	4.0
% in total UK	1.3	1.3	1.3	1.3	1.3	1.3
annual growth rate of active firms		4.1	4.7	7.3	2.7	-0.4

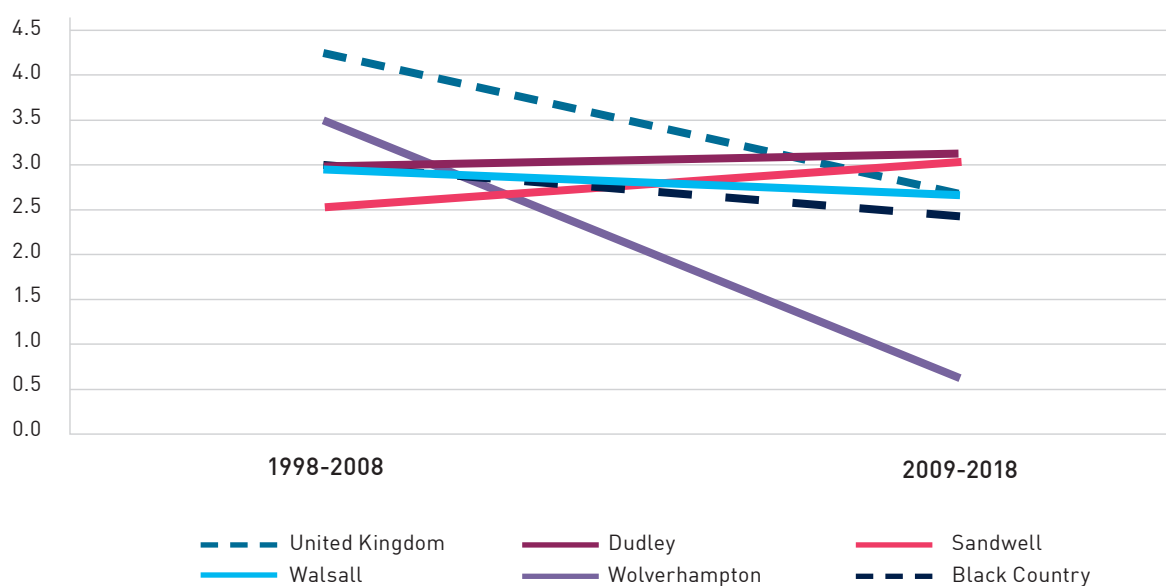
Source: ONS, Business Demography, 2013-2018

**Figure A1. Gross Value Added, annualised growth rate comparison 1998-2008 vs 2009-2018, Great Birmingham and Solihull LEP, %**



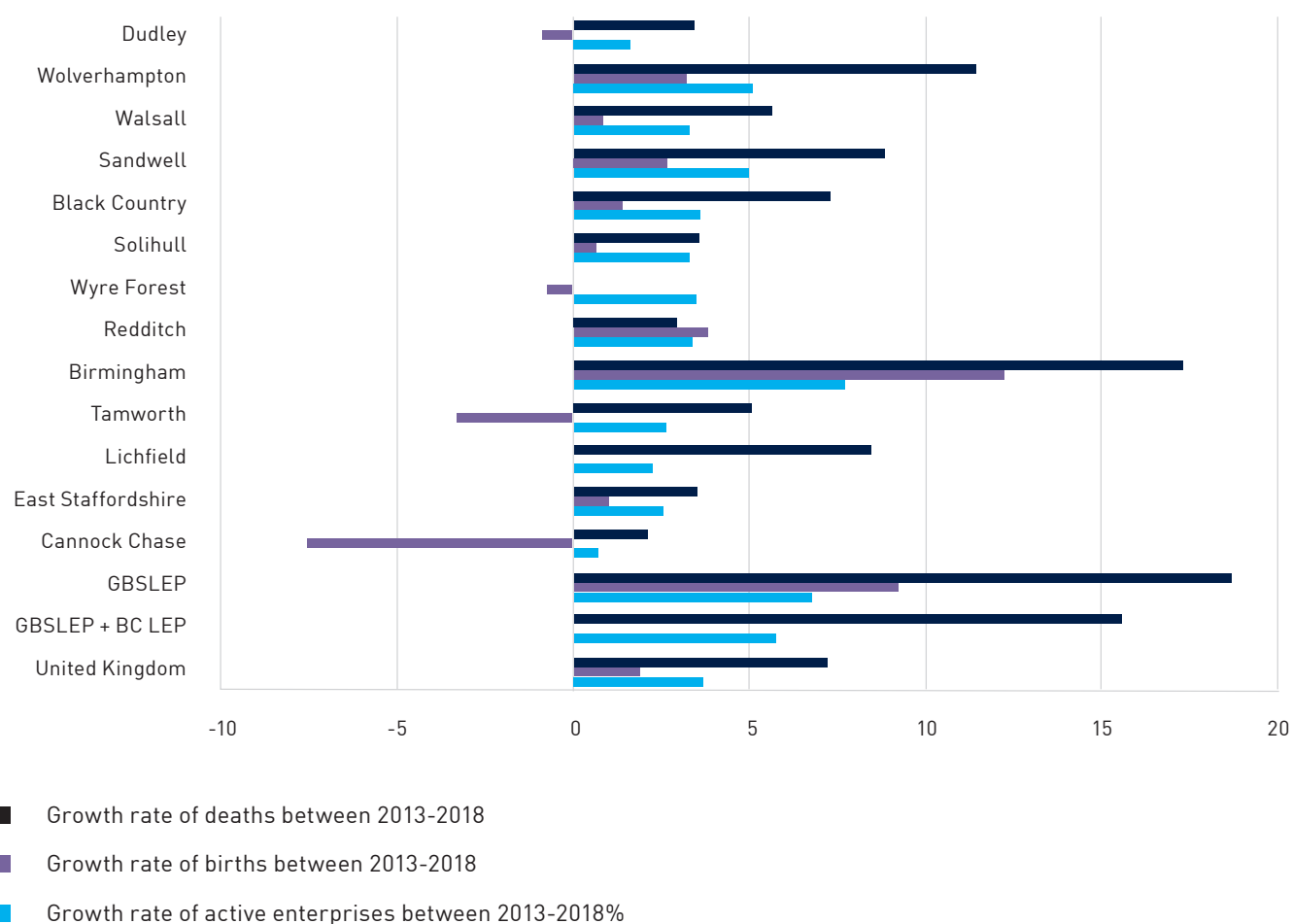
Source: ONS

**Figure A2. Gross Value Added, annualised growth rate comparison 1998-2008 vs 2009-2018, Black Country LEP, %**



Source: ONS

**Figure A3. Annualised growth rate of births, deaths and active enterprises between 2013-2018, %**



**Note:** Bromsgrove is excluded from the Figure, as the annualised growth rate of deaths in Bromsgrove local authority between 2013-2018 shows an enormous rate of 65% compared to other local authorities despite the annualised growth rate of births is 27%.

Source: ONS