The Creation and Growth of Small Business Service Firms in Post-Industrial Britain

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ABSTRACT. Since 1980, the United Kingdom has experienced a dramatic growth in firms and employment in information-intensive business services, such as management consultancy and market research. This article reports the results of the first substantial nation-wide investigation into the nature and causes of small professional business service firm growth in Britain, undertaken in 1991. It reveals marked differences in the characteristics, markets and competitive requirements of such firms, compared with small manufacturing firms. The demand for their services comes predominantly from large companies, and is more focussed on financial and other services and government. But small firms are also making increasing use of business services. Specialised expertise, reputation and educational and professional qualifications are essential prerequisites for the establishment of new business service firms. Their success is also being enhanced by increasing use of informal networking, collaborative partnerships, and subcontracting.

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Introduction

The role of service functions in modern economies has grown dramatically in recent decades. In Britain employment in services rose from 61.5% of the total work-force in 1981 to 72.1% in 1994. In some interpretations, this has been seen as a challenge to the prime position of manufacturing as a source of innovation and economic growth, with the resultant "post-industrial society" (Bell, 1974) characterised by the dominance of service employment and output. Against this, however, the fastest growth in services during the 1980s took place in "producer services" such as management consultancy, computer services, and technical and financial services. To the extent that these activities are inextricably linked to if not dependent on manufacturing and other production sectors (Wood, 1988; Britton, 1990), the growth of producer services thus reflects not the decline of industry but the growing complexity of production functions and organization (Walker, 1985). Investigation of the role and growth of producer service enterprises is thus arguably of central, not marginal, importance for understanding contemporary economic change in advanced economies.

Business services have a double significance for the study of small firm development. In Britain, at least, they were the most dynamic element in small firm growth in the 1980s (Keeble *et al*., 1994), while they provide valuable expertise to other firms, small and large, which enhances their competitiveness. The recent growth of small business service firms in Britain has been greater in volume and rate than that of any other sector of the economy. Between 1985 and 1992, the number of management consultancy and computer service firms registered for VAT increased by 177% and 106%, respectively, or

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+7,600 and +15,000 businesses, notwithstanding the acute early-1990s recession. The great majority of these were small firms, employing 10 or fewer professional staff. Small producer service enterprises also differ significantly in characteristics, origins, and performance from small manufacturing firms, on which most previous small business research has tended to focus. Manufacturing-based explanations for small firm growth are in fact almost certainly inappropriate for explaining the role and dynamics of these small business service enterprises.

This paper thus charts in depth the key characteristics and processes underlying the growth of small information-intensive business service enterprises in Britain, including their market orientation, competitive strengths, origins and entrepreneurial characteristics, the reasons for the increasing use of their expertise by clients, and the role of networking as a means of enhancing small firm flexibility and customization of service provision. Throughout, the paper highlights significant differences in operating characteristics and growth dynamics between such enterprises and small manufacturing firms, as well as between different categories of professional business service enterprises such as management consultancies, computer service companies, and design and market research firms. The analysis uses hitherto unpublished original evidence drawn from the Cambridge University Small Business Research Centre's (1992) nation-wide survey of small and medium-sized enterprises (SMEs) in Britain.

Methodology

The sampling framework used in the SBRC's extensive postal survey was the Dun and Bradstreet database, with its origins in the credit rating business. This source provides national coverage of data on firm activity, legal form and employment, and has been used in a series of influential U.K. SME job generation studies (Daly *et al.*, 1991; Atkinson and Storey, 1994). Stratified random sampling of this database by size band within the 1–500 employment range and telephone screening were used to identify a target population of 6,170 manufacturing and business services sector SMEs. A postal questionnaire survey was then carried out between April and September 1991, which yielded a response rate of 32.9% or 2,028 completed usable questionnaires.[1]

The sub-sample of business service firms was deliberately targeted at four information-intensive SIC activities: 8370, *Professional and Technical Services not Elsewhere Specified*;[2] 8380, *Advertising*; 8394, *Computer services*; and 8395, *Business services, not elsewhere specified.*[3] A total of 851 firms, or 93% of all service firms which responded to the survey, fall into these four categories (Table I). Of these, 53% were from firms classified into SIC activity category 8395. To overcome some of the problems associated with the SIC classification of service firms this category has been recoded into four groups: (1) *Management Consultants, Marketing and Sales, and Technology Consultants*; (2) *Personnel and*

TABLE I
The distribution of business service firms by size

Employment size	Number of firms							
	All firms	8370	8380	8394	8395			
					Group 1	Group 2	Group 3	Group 4
1–9	326	38	17	73	68	34	37	59
10–99	413	90	47	79	64	29	40	64
100–199	63	22	1	9	14	3	1	13
> 200	39	11	–	6	3	3	3	13
Total	841	161	65	167	149	69	81	149

Notes: 8370 = Professional and technical services, not elsewhere specified; 8380 = Advertising; 8394 = Computer services. Group 1 = Management consultants, marketing, sales and technology consultants; Group 2 = Personnel and public relations; Group 3 = Design and market research; Group 4 = Other business services.

Public Relations Firms; (3) *Design and Market Research Firms*; and a residual group of (4) *Other Business Services*.[4] This last group accounts for 18% of responses and its miscellaneous composition means that it will usually be ignored in the forthcoming analysis.

In conjunction with this extensive postal survey, the authors also undertook an intensive face-to-face interview survey of 120 small independently-owned and managed business service firms, equally divided between management consultancy and market research organizations. Choice of these two sectors as case studies reflects their strategic importance in providing specialised and essential information to a wide range of private and public sector organisations, their rapid recent growth rates, and their large number of small firms (Keeble *et al*., 1991). Equal numbers of firms in each sector were interviewed in South East and northern England. The survey was carried out between January and July 1991, and achieved a response rate of 75%. Its principal conclusions have already been widely reported (Keeble *et al*., 1992a,b, 1994; Bryson *et al*., 1993a,b, 1994; Wood *et al*., 1993). The findings of this survey, hereafter referred to as the *Business Service Survey* (BSS), are here used to provide qualitative insights and interpretations of the results of the SBRC nation-wide postal survey.

Small business service firms and the production process

Since 1981, information-intensive business services employment (SIC 8395) in Britain has grown at a remarkable rate, of +244% or 374 thousand jobs to 1994, notwithstanding two severe recessions. This growth represents the latest stage in a continuing 20th century process of technological and organisational restructuring of production and labour skills, which has required increasing managerial inputs, the creation of a management division of labour, and the development of specialised management expertise in areas such as marketing, market research and personnel. These new management areas have acquired their own terminologies and methodologies and have gradually transformed themselves into professions (Johnson, 1972; Perkins, 1989). The history of capitalist production is thus associated with a constant division and specialisation of activity and the growth of a professional middle class. It is this class that is at the centre of the modern service economy (Urry, 1986; Savage *et al*., 1988).

Increased international competition, technological change, recessionary forces and changes in the needs of organisations are thus creating a growing demand for specialist service firms, providing new innovatory services, information and advice needed to enhance client competitiveness in a rapidly-changing macro-economic environment. Large firm rationalisation and concentration on core activities to produce the lean, delayered company (Harvey, 1989, p. 150) has also externalised service demands previously supplied by internal management.

These processes, but primarily growing demand for new services, are responsible for the rapid growth of small business service firms. Such firms supply intangible but value-adding inputs into the client production process, provide expertise which is embodied in key professionals, and work very closely with clients, most of whom are large enterprises. Their internal and external operating environments are very different from those of small manufacturing firms, on which most research has hitherto focussed.

General characteristics

Rapid small firm growth in Britain since 1980 (Dunne and Hughes, 1990; Keeble, 1990), which has recently resumed after some losses during the 1989–93 recession, has been focussed on information-intensive business services. These have recorded appreciably higher rates of small firm expansion than consumer services, financial services or manually-based support services (Bryson *et al*., 1993a). The small size of professional business service firms is clearly indicated by a median employment size of 15 for all business service firms in the SBRC sample, with 38% of firms employing less than 10 people and 88% less than 100 (Table I). The median values for specific service activities are in fact generally below 15 employees, with a value of only 10 employees for personnel and public relations firms (Group 2) and 11 for design and market research (Group 3): the highest median of 30 employees is recorded by architects and consulting engineers (SIC 8370). Small firms are thus particularly prevalent in personnel and public relations (Group 2; nearly 50% of firms employ less than 10 staff), management consultancy (Group 1; 46% of firms with less than 10), design and market research (Group 3; 46% of firms), and computer services (SIC 8394; 44% of firms).

The generally small size of business service firms partially reflects the intrinsically high labour-intensity of information-based business services, "professional expertise" being a commodity whose production and delivery cannot easily be automated. Growing demand is thus directly reflected in growing employment and numbers of small service firms. This also however reflects the crucial role of individual expertise and contacts. Small business service firms are largely established by their founders leaving potential client firms or rival companies, taking contacts and maybe even clients with them. The larger firms become, the more difficult it is to control this break-away process and, in the case of business service firms, for the owner to maintain personal contacts with all of the firm's clients. Thus small business service firms can sustain a key competitive advantage over larger firms – the ability to offer expertise and a personal and flexible service. It is this skill base and customized orientation to client needs that is one of the most significant differences between small manufacturing and service firms.

Between 1987 and 1990 the median employment growth rate of all small business service firms surveyed was +40%, or more than double the medium growth rate for small manufacturing firms (+18%). However, computer service firms (SIC 8394) and management consultancies (Group 1) were significantly above the business services median. The rapid growth of computer service firms is partially explained by the fact that 77% were established during the 1980s so that many will not have reached their growth potential. The ever-increasing complexity of computer systems has encouraged small manufacturing and service firms to seek advice from computer service firms. Thus the SBRC survey found that the second most frequently used group of external advisers amongst small manufacturing and service firms was computer consultants (Small Business Research Centre, 1992, p. 30). The employment growth of management consultancy firms (median value of +50%) appears to be associated both with changes in the organizational structures of client firms, and rapid growth in demand for specialized expertise and information (Wood *et al*., 1994). When actual growth rates, rather than median values, are analysed, only 27.7% of the 675 firms who supplied data for 1987 and 1990 showed stable or declining employment, while exactly one-third grew by over 75%.

Employment growth rates reveal nothing about the skill composition of the work-force of small business service firms. This is markedly different from that of small manufacturing firms, which have a large share of unskilled, semi-skilled and skilled manual workers, whereas small business service firms have a much greater propensity to employ clerical, administrative and professional staff (Table II). Service firms employ a much higher proportion of professionals, including technologists, and managerial staff than manufacturing

TABLE II
The skill composition of manufacturing and service firms

	Representative firm (% employment)		Net employment change (%)	
	Manufacturing	Services	Manufacturing	Services
Semi-skilled and unskilled manual	34.0	11.7	+5.2	+21.6
Skilled manual	29.0	8.4	+7.6	+23.3
Clerical and administrative	14.3	24.1	+8.0	+20.9
Technicians and lower professional	6.8	16.7	+11.7	+23.0
Technologists, scientists and higher professionals	3.7	21.9	+16.7	+27.0
Managerial	12.2	17.2	+7.6	+17.6
Total	978	851		

firms, reflecting their provision of technical skills and management expertise to clients.

The growing importance of female entrepreneurship in some service sectors is indicated by the relatively high proportion of small firms which employed female managerial staff (30%). Just over one-third of the employees of all surveyed service firms were female. Architects and other property services (SIC 8370) employed the lowest proportion (22.3%), followed by "other services" (Group 4, 35.2%), and management consultancy (Group 1, 37.4%). The highest proportion of female employees were in design and market research (Group 3, 50.6%) and advertising (SIC 8380, 48.9%). This supports the evidence from the Business Service Survey, which found that only 48% of consultancy firms employed women professionals, compared with 87% of market research companies, several of which had been founded by female entrepreneurs (Wood *et al.*, 1993).

Surveyed firms were also asked to identify those skill groups in which employment had either significantly increased or decreased since 1987 (Table II). The net increase (% of firms reporting a significant increase minus % of firms reporting a significant decrease) shows that in all skills higher net proportions of small service firms experienced significant net employment growth than was true for small manufacturing firms. The greatest overall increase for service and manufacturing firms was in technologists, scientists and higher professionals (+27% and +16.7%), as well as technicians and lower professionals (+23.0% and +11.7%) and skilled manual workers (+23.3% and +7.6%). The relatively high net increase of skilled manual workers is explained by the diversity of the service sector, including low skill activities such as security services and debt collectors (Group 4), as well as information-intensive activities, such as consultancy services (Group 1).

A frequent explanation for the rapid growth in the numbers of small business service firms is low capital barriers to entry. This is partially supported by the finding of this survey, since service firms in the SBRC sample have low capitalization rates and low interest payments. In 1987 just over fifty per cent (51%) of service firms paid no interest, in comparison to 37% of small manufacturing firms. By 1990, however, these proportions had been reduced to 32% and 27% reflecting the onset of the recession, and perhaps also the rapid growth of small service firms which required additional capital. Between 1987 and 1990 the ratio of interest payments to profits also increased for both manufacturing (8.4% to 8.9%) and service firms (2.5% to 5.9%). Service firms, however, report lower levels of interest payments than manufacturing firms.

The most striking feature of the regional distribution of small business service firms in Britain is the dominance of the South East which accounts for no less than 58% of all small and medium-sized business service firms surveyed (Keeble and Bryson, 1996). In contrast, just under two-thirds of the SBRC sample of manufacturing firms (63.3%) were based in northern Britain. Though derived from a Dun and Bradstreet sampling frame which probably excludes many very small enterprises, these figures are closely comparable to the separate business services employment statistics presented in Bryson *et al*. (1993a). Southern Britain as a whole accounts for 72% of all business service firms in the sample. The very clear focus of information-based business services in Britain upon southern England is further highlighted by the fact that South West England (47 firms) accounts for nearly as many firms as Scotland (49), and substantially more than Wales (20 firms) and Northern England (22 firms) combined. Of the 851 business service firms in our sample no less than 288 are located in the South East outside London. This pattern may reflect the movement of firms from Greater London to the surrounding area as well as enhanced new firm formation rates outside the capital (Keeble *et al*., 1991). Evidence from the BSS suggests that small management consultancy and market research firms are establishing themselves in the rest of the South East both by moving out from the inner London "seed-bed", and spinning off from clients and competitors in the rest of the South East itself, which during the 1980s also acquired an increasing share of headquarter and divisional offices of major manufacturing and service companies. This decentralisation reflects powerful "lifestyle" and residential preference motives on the part of the entrepreneurs involved (Keeble and Tyler, 1995), together with the ease of communications and transport from home and low office costs in the rest of the South East (Wood *et al*., 1993).

Firm formation

The process of new business service firm formation is dominated by new start-ups (74.5% of all service firms) and by spin-offs from existing businesses (18.5%) (Table III). The BSS survey revealed that the normal firm formation process for both management consultancy (84%) and market research firms (77%) involved founders spinning-off from other consultancy and research companies or from client companies (Bryson *et al.*, 1993a; Wood *et al.*, 1993). As far as service firms are concerned there appears to be little difference between a "spin-off" and a "new start-up". In information-intensive business services the founders of new firms must acquire experience, reputation, knowledge and contacts. It is thus likely that in most cases service firms which identified their establishment as a "new start-up" were also in reality "spin-offs" from a client or rival company. If we add spin offs and new start-ups together this new category accounts for the establishment of over 93% of small service firms in the sample.

The small proportion of business service firms established by management buy-outs (4%), and by mergers (3%) is to be expected given the information-intensive nature of business service activities and low barriers to new firm formation. Merger is seldom a sensible option for small business service firms as the movement of professional staff between firms is extremely flexible. Consequently any acquired firm may rapidly lose its most valuable assets – its professional staff. In comparison to manufacturing firms the significance of capital assets is very low. Partnerships and firms are thus frequently established, dissolved and re-established depending on factors such as the compatibility of partners or the location of the partners' homes. The only business service activity which experienced a significant proportion of management buy-outs was advertising and bill posting agencies (SIC 8380) (12% of firms). All of these occurred during the 1980s and were probably caused by either the externalization of advertising departments from client firms or the retirement of the owner. In the advertising industry acquisitions or management buy-outs were usually financed by "earn-outs" which pay off the agency's founder over an agreed period of time (The Economist, 1990, p. 5).

One of the most frequently-proposed explanations for the dramatic recent growth in manufacturing firm formation is rising unemployment and recession-push mechanisms (Keeble and Wever, 1986). The SBRC survey indicates that this was also of some importance for new small business service firms, where recession-induced "actual or potential unemployment" helped to stimulate the establishment of 27% of firms, slightly below the figure for manufacturing (28.4%: Kitson, 1995). The evidence of the BSS survey, however, suggests that most of these are likely to relate to the potential rather than actual unemployment of expert staff, leaving previous employers voluntarily because of attractive severance terms, lifestyle factors, age, or the identification of a market niche for new firm formation. Not surprisingly, unemployment-push appears to have been more important in the 1980s than during earlier periods. Just under one-third of firms formed during the 1980s cite unemployment as one reason for establishing their own business, compared with only 17.6% of those formed before

TABLE III
The process of new business service firm formation

	All firms	Pre 1979	Post 1979	8370	8380	8394	Group 1	Group 2	Group 3	Group 4
New start up	621	237	381	116	47	129	117	50	60	102
Spin off	154	44	108	26	7	28	28	16	19	30
Total	775	281	489	142	54	157	145	66	79	132
Management buy-out	33	3	30	5	8	5	3	2	3	7
Merger	25	11	12	10	3	2	3	1	1	5
Total	833	295	531	157	65	164	151	69	83	144

1980 and surviving to 1990. Potential or actual unemployment is also more significant among the smallest firms (1–9 employees), where one-third of respondents report establishing their business as a consequence of it.

It must also, however, be noted that a substantial majority of firms (72%) were established for other, and relatively more positive reasons. The detailed BSS survey of management consultancy and market research firms found that actual redundancy had stimulated the establishment of relatively few firms (12%), and even fewer firms (8%) ranked "as an alternative to unemployment" as their prime motivation (Bryson *et al*., 1993a). New business service firm formation may be especially stimulated during phases of corporate reorganization when skilled managerial or technical employees choose to take advantage of redundancy terms. In these circumstances the simple relationship between unemployment and new firm formation must be treated with caution. New firm formation more frequently reflects the perceived advantages and attractions of small firm owner-management. The BSS interview survey identified five leading motivations more important than unemployment for establishing a new business service firm, accounting for 73% of total responses, involving enhanced personal satisfaction and betterment, greater independence, financial gain, job satisfaction, and intellectual stimulus (Keeble *et al*., 1992b).

A much more striking difference between business service and manufacturing SMEs is that the professional and educational qualifications of SME directors, partners and sole proprietors are significantly higher amongst the former than the latter (SBRC, 1992). Thus only 38.4% of manufacturing SMEs had at least one director, partner or proprietor with a degree, whereas this was true of 56.0% of business services firms. The latter also more frequently possessed at least one director, partner or proprietor with a professional qualification (68.2%) than manufacturing firms (only 56.8%). This evidence highlights the importance of educational qualifications and professional expertise in business service firm formation. It also indicates the role of these firms as a resource of high quality expertise.

Market orientation

The growth of small business service firms can only be understood in relation to the part they play in wider changes in business organization, most directly in terms of the changing needs of clients (Wood, 1991; O'Farrell and Hitchens, 1990a,b; Wood *et al*., 1993). The role played by small business service firms in the wider economy is indicated in Table IV, which confirms the BSS evidence that clients are drawn from a wide range of sectors (Wood *et al*., 1993). Clients are, however, more likely to be other business service and financial firms, and the public sector, than is the case with small manufacturing firms. These are more likely to sell to retailers, wholesalers and other manufacturers. The clients of small business service firms are also predominantly large firms (53.1% of firms sell "primarily" to clients with over 200 employees), confirming that small firm expertise is valued by large companies (Bryson *et al*., 1993b; Wood *et al*., 1993).

Although the business service firms in the survey operate under a variety of competitive conditions, the average small service firm is more likely than its manufacturing counterpart to depend on relatively few customers (SBRC, 1992). Nonetheless, Table IV shows that the principal client accounts for less than one-quarter of sales in over 60% of business service firms. Repeat business and former clients are extremely important sources of work for small business service firms (Bryson *et al*., 1993b). Just over half the firms rely on their five largest customers to provide over 50% of their sales (Table IV). Client dependency may alternate between different companies reducing the overall risks of dependency caused by a limited client base. In contrast to the SBRC survey the BSS survey shows that market research firms serve numerous clients in each year, and only in the Rest of the South East does a high proportion of management consultancy firms rely on less than a dozen clients. Less than one-third of the BSS sample firms in both sectors depended on a single client for more than 25% of their business. Most companies served more than a dozen clients per year, but tended to circulate around them. Thus, repeat business dominates the market research industry, and was the most important single source of work for

TABLE IV
Markets and clients of small firms

	Firm sales (mean %)					
	Retailers and wholesalers	Manufacturers	Other firms	Local or central government	Direct to the public	Other
Services	11.5	26.7	34.3	9.8	7.0	10.6
Manufacturing	28.0	33.9	23.5	4.8	5.3	5.5
Total firms	20.4	30.0	28.6	7.1	6.1	7.9

	Client size (mean %)			
	Less than 200 employees	More than 200 employees	Both small and large clients	Don't know
Service firms	37.6	53.1	4.9	4.4

	Dependence on large or few clients (% distribution of firms)				
	Less than 10%	10% to 24%	25% to 49%	50% to 75%	76% to 100%
% of sales by service firms to:					
Largest customer	26.6	35.0	22.0	10.4	5.9
Five largest customers	7.1	15.8	24.6	27.1	25.4

management consultancy firms (Wood *et al.*, 1993).

The relationship between small business service firms and their clients depends on the sources of their competitive advantage. Surveyed firms were requested to rank eleven possible competitive advantages from 0, completely unimportant, to 9, highly important. The means of these ranks are shown in Table V. For small business service firms the most important competitive advantages are "personal attention to client needs", "specialised expertise or products", and "established reputation". All three are ranked higher than by manufacturing firms, which instead stress "product quality" and "speed of service". These three dominant competitive advantages appear to be essential for the successful survival and growth of business service firms, which exist to provide customized and specialised services which satisfy the individual requirements of particular client firms. Reputation is essential for service firms in the acquisition of clients and is based on the quality of specialized expertise, word-of-mouth recommendation and repeat business. The BSS showed that repeat business provided on average just under two-thirds (61%) of small firm assignments by value, and that personal contacts between business service firms and their clients, or between clients, accounted for 61% of management consultancy, and 76% of market research firms' last three assignments (Bryson *et al.*,

TABLE V
Factors which contribute to competitive advantage

		Mean Rank*	
		Service SMEs	Manufacturing SMEs
1	Personal attention to client needs	7.8	7.3
2	Specialised expertise or products	6.8	6.0
3	Established reputation	6.8	6.7
4	Speed of service	6.3	6.7
5	Product quality	6.1	7.2
6	Range of expertise or products	5.4	5.2
7	Flair and creativity	5.2	4.1
8	Price	4.8	5.8
9	Marketing	4.7	3.9
10	Cost advantage	4.2	4.3
11	Product design	3.9	4.7

* These are means of ranked data. 0 indicates that the factor is completely unimportant and 9 indicates that it is highly important.

1993b). This explains the low (though higher than manufacturing) ranking of "marketing" as a competitive advantage, since many business service firms do not need to engage actively in marketing. The importance of specialisation for small business service firm success is very powerfully attested by the BSS survey, which found that specialised management consultancies grew seven times faster that non-specialised, "generalist" consultancies (Keeble, Bryson and Wood, 1994). "Price" and "cost advantages" appear to be relatively unimportant compared with customization, reputation and specialized expertise. These findings challenge much traditional economic theorising on the determinants of small firm success, which is based on manufacturing rather than service models of the firm.

Growth constraints

Much of the work and Report of the 1971 *Bolton Committee of Inquiry on Small Firms* centred around the problems and limitations then facing British SMEs, especially those relating to finance and taxation, government procurement, monopoly policy and training and advice. Given the dramatic changes occurring in the economy over the last twenty years the SBRC survey enquired about the constraints currently experienced by small and medium-sized firms. Surveyed firms were requested to rank nine factors from 0, completely unimportant, to 9, highly important, which may have acted as a significant limitation on their ability to meet their business objectives over the previous three years (1988–1991) (Table VI). Financial constraints were identified by the Bolton report as an important limitation on SME growth and development. Table VI reveals that British SMEs still think that this is the case, notwithstanding 1980s government initiatives such as the Business Expansion and Loan Guarantee schemes. Thus the two most important limitations reported by both manufacturing and service firms were the "availability and cost of finance for expansion" (4.79) and "the availability and cost of overdraft finance" (4.68). These replies may however primarily reflect the high interest rates of the study period, while Cosh and Hughes (1994) have recently challenged the view that capital shortages significantly constrained small firm growth generally in Britain in the 1980s.

The third and fifth most highly rated constraints

TABLE VI
Constraints on ability to meet business objectives by sector

Constraints	Mean rank*							
	Services	Manufacturing	8370	8380	8394	Group 1	Group 2	Group 3
Availability and cost of finance for expansion	4.79	5.10	4.73	4.32	5.33	4.60	4.59	4.10
Availability and cost of overdraft finance	4.68	5.10	4.67	4.07	5.12	4.32	4.49	4.63
Overall growth of market demand	4.51	4.89	4.99	5.32	4.52	4.01	4.17	4.23
Marketing and sales skills	4.24	4.05	4.27	3.60	5.53	3.91	3.39	3.78
Increasing competition	4.13	4.50	4.50	4.11	4.14	3.71	4.17	4.23
Management skills	3.84	3.85	4.00	4.18	4.47	3.51	2.83	3.89
Skilled labour	3.23	3.59	3.79	2.98	3.79	2.85	2.56	3.29
Acquisition of new technology	2.12	2.49	2.47	2.50	1.84	1.74	1.73	3.01
Availability of appropriate premises or site	2.03	2.15	2.03	1.52	2.20	1.82	1.62	2.81
Difficulties in implementing new technology	1.98	2.33	2.47	2.21	1.82	1.74	1.41	2.79
Access to overseas markets	1.60	2.17	2.14	1.31	1.71	1.96	0.77	1.85
Total responses	816	1025	149	62	163	148	66	82

* These are means of ranked data. 0 indicates that the factor is completely unimportant and 9 indicates that it is highly important.

reported by business service firms are "market demand" and "increasing competition", both of which undoubtedly reflect the impact on surveyed firms of the severe early-1990s recession. Perhaps of greater longterm significance, however, are the fourth and sixth most highly rated constraints, of "marketing and sales skills" and "management skills". Indeed, it is noteworthy that the former is the only constraint ranked higher by business service than by manufacturing SMEs, service firms rating all other constraints lower than their manufacturing counterparts. Although "marketing" was given a low rating as a competitive advantage in Table V, marketing skills represent a significant constraint because of the difficulties small business service firms face in marketing relatively intangible "products". The BSS highlighted the greater importance of marketing for small business service enterprises located outside the South East and in areas without large potential client markets (Wood *et al.*, 1993). Small business service firms must maintain their presence in the marketplace, but are frequently unable to do so during periods of work overload. This may result in subsequent periods of underemployment in which marketing and the attraction of new clients or repeat business is vital for survival. Limited marketing, sales and management expertise thus appears to be an important issue for small business service firm survival and growth in the 1990s.

Differences in responses between SMEs in different business service sectors are also noteworthy. Thus computer firms (SIC 8394) report exceptionally severe financial constraints and problems with management, marketing and sales skills. These findings probably reflect the exceptional growth rates of computer service firms, together with national shortages of computer professionals and managers. Architects, surveyors and consulting engineers (SIC 8370) ranked problems of finance and market demand highly, but compared with other business services they more frequently emphasized constraints arising from competition, skilled labour availability, implementing new technology and access to overseas markets. For advertising firms (SIC 8380) the outstanding problem of the early 1990s was the collapse of market demand and billings because of the recession, although this group also reported above-average constraints in terms of management skills. Management consultants (Group 1) rated all constraints lower than the average for business services, except access to overseas markets. This reflects the significant role such firms play in exports: the BSS found that exports accounted for 11% of sales of small management consultancies (Keeble *et al.*, 1992b), double the share for market research firms for example. Personnel and public relations firms (Group 2) also reported lower than average constraints on all factors except increasing competition. Finally, design and market research firms (Group 3) reported relatively low ratings for the leading constraints, but above-average scores for low-ranking constraints such as acquisition and implementation of new technology, and premises. In general, management consultancy, personnel/public relations, and design/market research SMEs seem to find most listed problems less constraining than other sectors, perhaps reflecting the burgeoning demand for their specialised expertise during the 1980s, together with low capital, technology and premises requirements.

Business advice and external experts

With the increasing complexity of the business environment, economic turbulence, intensifying competition, accelerated internationalization and rapid technological change, the demand for and expenditure on external business advice has grown rapidly, a growth which has involved small as well as large client companies. To investigate this, manufacturing and service SMEs were asked about their use of external firms and experts in eleven areas over the previous three years, ranging from market research to taxation and financial management. No less than 85.8% (1,741 firms) of small and medium-sized manufacturing and service firms reported using external professional advice in at least one area of their business during this period. This in itself indicates the dependence by British SMEs on external information and advice.

The survey reveals that there is a marked tendency for the use of external business advice by small and medium-sized enterprises to increase over time (SBRC, 1992). Of the total responses from the 730 service firms (85.8%) which reported using external advice in at least one area of their business, there were 1483 instances (57%) of increased use in particular areas, 799 instances (31%) of no change in use, and only 315 instances (12%) of decreased use. Increased demand for professional advice by SMEs is thus demonstrated to be one factor in the proliferation of small business service enterprises in Britain in the last decade (Keeble *et al*., 1992b).

By far the highest reported use of external experts was for “taxation and financial management” (63% of all firms), with service firms being appreciably more likely to have sought such advice (69%) than manufacturing firms (57%). Not surprisingly, computer service firms are the second most highly used group of external advisers, with manufacturing firms employing them more frequently (51%) than service firms (43%). However, seventy per cent of business service firms already using external computer service experts had increased their use of advisers, reflecting the increasing importance of computer technology for service SMEs.

The next two most frequently used areas of external business advice were “marketing” and “business strategy”. Three in every ten small firms reported having sought the help of marketing consultants, with more service firms (34%) employing them than manufacturing businesses (26%). The significance of and need for marketing consultancy advice appears to be a recurrent theme in the results of the SBRC survey. We have seen that marketing is one of the most important limitations on growth reported by computer service firms (SIC 8394) (Table VI) and thus more computer firms (45%) employ marketing consultants than any of the other seven service categories in this study. Over the last three years 30% of firms had employed independent business strategy advisers, almost certainly management consultants, while 63% of these firms had increased their use of such consultants. At least a quarter of all SMEs in the sample had also sought help over the introduction of new technology (26%) and improved management organization (25%). Overall, it is the areas of taxation and financial management, computer services, marketing, business strategy, and the introduction of new technology and improved management organization, in which SMEs seek help most frequently.

Interesting firm size differences in the use of external advisers were also identified. Variation with firm size in the externalization of service supply is a well-documented phenomenon. Ochel and Wegner (1987) hypothesize an “inverted U” relationship, which expects lower levels of externalization of services both by small clients (because they do not need, or cannot afford external services) and by large clients (with more in-house provision), compared with those of intermediate size. The SBRC sample was specifically targetted at SMEs, and thus the size range of client companies is constrained at the upper end. In the majority of cases, micro-firms (1–9 employees) consistently record the lowest frequency of use of external business advisers, and larger firms (100+ employees) the highest, with small firms of between 10 and 99 employees invariably falling between these extremes. Frequency of use of external advice by firms employing 10 or more staff was not, however, significantly affected by client size for computing services, business strategy and new technology. There is some limited evidence, but no consistent pattern, to support the “inverse U” hypothesis for taxation and financial management, personnel and recruitment and management organization. In these activities, larger clients may tend to reduce their dependence on outside services, but this reduction is not very significant. A consistent and systematic increase in usage frequencies with increasing size of firm was found only for advertising, public relations, market research and at a very low level product design. The much lower use of external advice by micro and small businesses almost certainly reflects their more limited financial resources, market coverage, technological sophistication, and growth objectives. The fact that small firms are significantly less likely than large firms to seek external professional advice on business strategy, marketing and technology/computing may, however, support arguments for continued if not enhanced public sector provision of consultancy advice to small businesses in these areas.

The surveyed firms were also asked an open question about the reasons for their increased or decreased use of external advice. The most frequently reported influences on increased use were “to aid business growth and competitiveness” (35% of responses), “technological reasons” including computerization (15%), and the "increasing complexity of the business environment" (13%). These responses suggest that SMEs perceive a growing need for external professional advice in order to maintain or enhance their competitive and commercial performance. The main reason for decreased use of external advice given by firms was that such advice proved unsatisfactory or expensive (7%).

Business networks and small firm flexibility

An important competitive advantage of business service SMEs is flexibility in being able to respond rapidly to changing client needs. Indeed, the BSS survey sample ranked flexibility as the fifth most important advantage recognised by such firms. Small business service firms are inherently flexible in serving clients. But many are also enhancing their flexibility by employing the complementary services of other experts or firms. Small business service firms which specialize in particular industries, techniques or regions may also be employed as subcontractors by large organizations. These types of relationships reflect the importance of specialized expertise for business service firms and the economies of informal and formal linkages which exist between firms.

A debate has developed around the nature of these links, or "networks", and the importance of "networking" in the small firm sector (Birley, 1985; Curran, *et al.*, 1991; Bryson *et al*., 1993b). A network is "a specific set of linkages among a defined set of persons, with the additional property that the characteristics of these linkages as a whole may be used to interpret the social behaviour of the persons involved" (Mitchell, 1969, p. 2). Curran *et al*. (1991) and Curran and Blackburn (1992) argue that "networks" can be usefully divided into two types: compulsory and voluntary networks. Compulsory networks are those which an organization must belong to in order to survive and operate successfully, for example with banks or accountants, while participation in the local chamber of commerce, golf club, family and other social groups would be classified as voluntary networking. Many of these are support networks (for example banks, enterprise agencies and business advisers), providing advice, information and capital (Curran and Blackburn, 1992, pp. 3, 4). This definition was used by Curran *et al*. in a study of the compulsory and voluntary networks of 350 small service firms. Focusing on voluntary networks they found that less than one-third of the sample were members of a trade association, and less than a quarter were members of the local chamber of commerce (Curran *et al*., 1991). The key conclusions were that such firms have relatively small networks, with limited use either of "compulsory" external advisers, or links with family and social groups.

The SBRC questionnaire asked business service firms to indicate whether they were voluntary members of particular business organizations. The findings reveal that the most popular business organization is membership of a professional association, covering just over a third of all service firms in the survey (300 firms, 35.3%). This is especially important for architects, surveyors and consulting engineers (SIC 8370) (50.3%), management consultants (Group 1) (45.7%), advertising and bill posting agencies (SIC 8380) (41.5%), and personnel and public relations firms (Group 2) (35.7%). The next most popular business organization was the local Chamber of Commerce, although this included only 32.2% of all service firms, followed by membership of a trade association (16.2%). The least mentioned business organization was the Confederation of British Industry (CBI), with only 29 out of 851 firms being members. These findings suggest that for information-intensive business services, membership of professional associations and the local Chamber of Commerce, although not a majority activity, is significantly higher than that reported in the Curran *et al*. study (1991; Curran and Blackburn, 1992).[5] No data was collected, however, into the use these firms make of their membership of these organizations. The existence and extent of membership of business associations, however, represents no more than a potential for interfirm collaboration.

To examine the extent of "networking" amongst small business service firms the SBRC survey asked SMEs to provide details of formal or informal collaborative or partnership agreements, or supply relationships, into which they had entered during the last three years. Just over one-third (38.8%) of all service firms, but only one-quarter of all manufacturing firms (25.7%), had entered into a partnership agreement or supply-related network relationship with another company. This significant difference reflects the importance of specialized expertise and the economies of informal and formal linkages between small business service firms. Within business services, computer service firms (SIC 8394: 52.4% of firms) and management consultancies (Group 1: 49.7%) were the most likely to have entered into a partnership agreement. The SBRC's survey figure for networking by management consultancy firms is in fact considerably lower than that of the BSS survey which found that 85% of firms were involved in supply-related networking (Bryson *et al*., 1993b). The SBRC result in fact almost certainly understates the true extent of networking amongst small business service firms as it ignores the widespread use of individuals, rather than firms, as associates on particular projects. This applies especially in market research, where only 37% of surveyed firms stated that they were involved in a supply-related network agreement, compared with 64% in the smaller, but more intensive BSS survey.

Subcontracting represents a further type of networking. This may be either demand- or supply-related, depending on whether the work comes from a client or from a similar type of firm. Just under 50% of the SBRC service firms were engaged in a subcontracting relationship with another company, a proportion which had grown during the previous three years. This is shown by a positive net change in subcontracting (+23.6% of firms), calculated by deducting the proportion of firms undertaking less subcontracting from the proportion of firms undertaking more, which is approximately double that for manufacturing (+14.4%). This may well reflect an increase in the contracting out, or externalization, of services during the 1980s as client firms concentrated on core activities, together with the increasing specialization of business service firms.

The SBRC survey also reveals that collaborative or partnership agreements are significantly more common among faster growing business service firms (45% of firms) than either medium growth (37%) or stable/declining firms (34%). This suggests that partnership arrangements are positively associated with business performance and growth. The three most important reasons for collaboration were to "expand the range of expertise" (19% of firms), "assist in the development of specialist services" (17%), and to "provide access to new U.K. markets" (14%). All these indicate that partnership arrangements, or networking, enhances the flexibility of small business service firms and permits them to offer a range of services, or to operate in specific markets, without having to employ additional full-time professional staff. This evidence suggests that many small business service firms are able to compete successfully, by price and by expertise, with large firms through the use of a variety of personal contacts, associates, business contacts and a variety of formal and informal collaborative agreements.

Conclusions

The preceding discussion has provided a variety of new insights into the remarkable recent growth of small information-intensive business service firms in advanced economies such as Britain, including hitherto unavailable information on small firms in such specific service categories as management, marketing, sales and technology consultancy, personnel and public relations, and design and market research.

The research reveals that rapid small business service firm growth reflects rapidly growing demand for specialised expertise and customised services from a wide range of client organisations. This demand growth comes predominantly from large companies, while markets differ from those of small manufacturing firms in being appreciably more focussed on finance, business and other service sectors, and on local and central government, although manufacturing clients are also very important. Repeat business and former clients are extremely important sources of demand. Small business service firms stress the vital importance of customisation and specialisation as major competitive advantages, unlike manufacturing SMEs, which stress product quality and speed of delivery. Specialised business service SMEs grow faster than generalist SMEs.

Within Britain, the location of small information-intensive business service firms is highly spatially uneven, and dominated by South East England, especially outside Greater London. This area provides a residentially attractive and relatively inexpensive "seed-bed" for firms set up by founders spinning off from South East clients and competitors, or small service firms moving out from London. Compared with manufacturing firms service firms have low capital and equipment barriers to entry with low capitalization rates and interest payments. Most small business service firms are established by founders who have acquired their reputations whilst working for large not small firms, while only a minority of firms were established as a result of recession-induced actual or potential redundancy.

Expertise, educational and professional qualifications are essential prerequisites for the establishment of most successful new business service firms. Such firms have high proportions of directors with degrees or professional qualifications, and employ much higher proportions of professional, administrative and clerical staff than manufacturing SMEs. Female entrepreneurship in business services is increasing in importance, with a significant minority of firms employing female managerial staff.

Small business service firms are inherently flexible in being able to respond rapidly to changing client requirements. This flexibility is however being powerfully enhanced by the growth of informal supply and demand related "networks" and collaborative partnerships. Small business service firms engage in more networking and subcontracting relationships than do manufacturing firms. This reflects the great importance of specialized expertise and the economies of informal and formal linkages which small business service firms can achieve in carrying out client assignments.

The findings of the SBRC survey are consistent with the view that small business service firms exert an important independent and innovative influence on the ways other businesses gain access to essential advice, information and expertise. The growing complexity, turbulence and rapidly-changing nature of the business environment since the 1970s has created a wide range of niches for flexible, but specialized, information-intensive small business service firms. However, the marked differences revealed by this analysis between small manufacturing and service firms clearly suggest that economic theories based implicitly or explicitly on manufacturing models are likely to be inadequate if not invalid in explaining dynamic recent small business service firm growth in Europe and North America. There is a great need for a service-focussed theory of small firm growth. Further research is also needed on the role small business service firms play in enhancing the competitiveness of their clients and why large clients select small firms in preference to larger competitors. Finally, how far is spatial decentralisation if not regional convergence of business service firm activity being constrained by the parallel growth of inter-firm networking, or enabled by the telecommunications revolution?

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Notes

[1] See *Small Business Research Centre* (1992) for a detailed account of the design and conduct of the survey and the characteristics of the sample respondents.

[2] This group comprises architects, surveyors, consulting engineers, independent design offices, testing centres, assay offices and analysts.

[3] This is a large group comprised of a miscellaneous collection of business services including management consultancy, market research and public relations consultants, document copying, duplicating and tabulating services, employment agencies, translators, typing services and trading stamp operators.

[4] Group 4 contains activities not covered by Groups 1–3 primarily engaged in providing services to other enterprises. It includes firms engaged in document copying, duplicating, tabulating, security firms, debt collectors, press agencies, freelance journalists, translators, typing services and trading stamp operators.

[5] This almost certainly reflects the inclusion in the Curran *et al*. study of a range of lower level services, the full list comprising printing, electronic firms, computer services, garage and vehicle repairs, employment, secretarial and training agencies, plant and equipment hire, advertising, marketing and design agencies, video hire leisure businesses,

and free houses, wine bars and restaurants (Curran and Blackburn, 1994).

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